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Turnover Actions and the "Floating Check" Controversy

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TURNOVER ACTIONS AND THE “FLOATING CHECK” CONTROVERSY

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Abstract

When a debtor files for Chapter 7 bankruptcy, a Chapter 7 trustee is appointed and is charged with collecting and reducing to money the property of the bankruptcy estate. One of the most basic collection methods a trustee possesses is its turnover power under section 542(a) of the Bankruptcy Code. Section 542(a) requires any entity that is in “possession, custody, or control,” during the bankruptcy case, of property that the trustee may use, sell or lease to turn it over to the trustee and account for such property or its value.

An interesting issue has arisen that is placing debtors in very problematic situations. Prior to filing for bankruptcy, debtors are writing and issuing checks, but the checks are not clearing until after the bankruptcy case is filed. Armed with the section 542(a) collection power, trustees are demanding that the debtor replenish the bankruptcy estate and turn over the

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account balance that existed on the date the debtor filed for bankruptcy. But debtors are refusing to comply with this demand because the funds represented by the checks are no longer in the account. So who is responsible for replenishing the estate for the transferred funds? Is the onus on the debtor to turn over the funds, even if those funds have been transferred from the estate to the payees? Or does the trustee bear the burden to seek the post-petition payments from the payees of the checks through avoidance actions?

This Article examines the “floating check” controversy and the language of section 542(a) of the Bankruptcy Code. It also examines a Chapter 7 trustee’s duties to maximize the bankruptcy estate for the benefit of creditors. This Article then reviews one of the leading cases on the floating check controversy, which holds that a debtor is not liable to the bankruptcy estate for the value of the funds if she lacks current possession or control of the actual funds at the time the trustee makes the demand for turnover. Several courts have followed this decision. These courts rely on pre-Bankruptcy Code practice and hold that turnover is permissible only when the entity has possession or control of the property at the time the turnover action is filed. Some of these courts also justify their decisions with policy-based arguments, analyzing who is in the “best position” to prevent transfers by post-petition check and remedy the damages to the bankruptcy estate.

After examining these arguments, this Article uses the relevant provisions of the Uniform Commercial Code governing the status of funds represented by an issued check to argue that a payee of a check only obtains

possession and control of those funds represented by the check once the funds are available to the payee. This Article then argues that the enactment of the Bankruptcy Code altered the pre-Code “current possession or control” requirement because section 542(a) expressly permits a trustee to recover “the value” of the property, in addition to the property itself, from one who possessed the property at any time “during the case.” As such, this Article concludes that if a debtor writes checks against funds pre-petition, but the checks do not clear the debtor’s account until after she files for bankruptcy, the trustee is entitled to a money judgment against the debtor for the value of the funds.

Finally, while this Article addresses the policy concerns, it raises a new approach that courts have failed to consider. Instead of analyzing who is in the better position to prevent transfers by post-petition checks or which party is in the best position to remedy the damages to the bankruptcy estate, this Article poses a simple question: which approach for recovering the funds is in the best interest of the estate and its creditors? This Article concludes that a Chapter 7 trustee has several, non-exclusive remedies and, in the exercise of his or her business judgment, may choose whatever recovery method is in the best interest of the estate. At times, recovering from the debtor might make the most sense because such remedy allows the trustee to recover the value of all the pre-petition checks from one source and without having to commence a lawsuit. Sometimes, however, recovering the funds from the payees of the checks provide the greatest return. Not only does this approach

comport with the trustee's duties under the Bankruptcy Code to maximize a return to creditors, but it is what section 542(a) and the Bankruptcy Code allow.

I. INTRODUCTION

“Timing is everything in bankruptcy.”¹ Shortly before filing for Chapter 7 bankruptcy, a debtor writes several checks from her checking account. But before the payees of the checks present them to the bank for payment, the debtor files for bankruptcy. A few days later—*after* the bankruptcy filing—the checks clear, leaving only a few dollars in the debtor’s bank account.

When a debtor files for Chapter 7 bankruptcy, a new legal person—the estate—is automatically created. To act on behalf of the estate, a Chapter 7 trustee is appointed, and is charged with collecting and reducing to money the property of the bankruptcy estate.² It is ultimately the trustee’s duty to collect property of the estate “as expeditiously as is compatible with the best interests of the parties in

¹ *In re Pauls*, No. 10-13887, 2011 WL 6096292, at *1 (Bankr. D. Kan. Dec. 5, 2011).

² 11 U.S.C. § 704(a)(1). All future statutory references are to the Bankruptcy Code as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 11 U.S.C. §§ 101-1532 (2005), unless otherwise noted.

interest.”³ One of the most basic collection methods a trustee possesses is its turnover power under section 542(a) of the Bankruptcy Code. Section 542(a) requires any entity that is in possession, custody, or control of property⁴ that the trustee may use, sell or lease to turn that property over to the trustee and account for such property or its value.⁵

In administering the bankruptcy estate, the trustee typically reviews the debtor’s bank account statements to determine if there were funds in her account on the date the debtor filed for bankruptcy. In the example above, because the checks did not clear the debtor’s bank account until *after* the filing date—post-petition—there were clearly funds in her bank account when she filed for bankruptcy. As a result, the trustee files a turnover action against the debtor, pursuant to section 542(a), demanding the debtor to turn over to the estate the account balance that existed on the date the debtor filed for bankruptcy. However, because the funds represented by the checks are no longer in the account, the debtor refuses to (or simply cannot) comply with the trustee’s demands.

Are the funds that the bank used to honor the checks property of the debtor’s bankruptcy estate and, therefore, subject to turnover? If so, who is responsible for

³ *Id.* § 704(1).

⁴ The “property” referred to pursuant in section 542(a) is essentially “property of the estate.” *See* 11 U.S.C. § 541(a)(1) (defining property of the debtor’s estate as “all legal or equitable interests of the debtor in property as of the commencement of the case.”).

⁵ *Id.* § 542(a).

replenishing the estate for the transferred funds? Is the debtor responsible even though she no longer has control or possession of the funds in the account and even if it means she will have to pay the funds twice—once to the payee to whom the checks were originally payable, and the second time to the trustee? Or is the trustee’s only remedy against the payees through separate avoidance actions? Or does the trustee have the choice whether to recover from the debtor or the payees?

Nearly all bankruptcy court decisions addressing this “floating check” controversy agree that if the funds are still in the debtor’s bank account on the petition date, then such funds are property of the estate. But section 542(a)’s second requirement of “possession, custody, or control during the case” is not clear-cut and courts have split over its interpretation. Some hold that the trustee bears the burden to seek the post-petition payments from the payees of the checks since the debtor no longer has *current* possession or control of the funds, while other courts put the onus on the debtor to turn over the funds, even if those funds have been transferred by the debtor’s bank to payees.

This Article argues that the latter courts are correct. If a debtor writes checks against funds pre-petition, but the checks do not clear the debtor’s account until after she files for bankruptcy, the trustee—if he or she so chooses—is entitled to a money judgment against the debtor for the value of the funds. Not only does this view comport with the plain language of section 542(a), but it is also may be the most practical and efficient way to maximize the value of the bankruptcy estate. Some courts that have considered the floating check controversy fail to consider the relevant provisions of the Uniform Commercial Code governing the status of

funds represented by an issued check. And several courts support their holdings on pre-Bankruptcy Code practice without appreciating the text of the current Bankruptcy Code. These courts hold that section 542(a) permits a trustee to compel turnover only from entities that have control of property of the estate *at the time* of the turnover demand. But what is absent in these courts' decisions is appropriate deference to the Bankruptcy Code's language giving the trustee the right to compel the delivery of "the value of such property" instead of the property itself. Similarly, several courts take the position that the trustee is in a better position than the debtor to recover funds from payees and, therefore, this somehow obligates the trustee to pursue these payees instead of the debtor. Such reasoning is flawed and inconsistent with the Bankruptcy Code and the trustee's duties to maximize the estate as "expeditiously as is compatible with the best interests of the parties in interest."⁶

Part II of this Article provides an overview of Chapter 7 bankruptcy. It begins by discussing a debtor's duties to cooperate as necessary to enable a Chapter 7 trustee to perform the duties given it under the Bankruptcy Code. One of those duties is to use its ability to compel the turnover of property of the estate to the trustee pursuant to section 542(a) of the Bankruptcy Code. This power is what entitles a trustee to recover a money judgment against the debtor for the value of funds withdrawn post-petition, even if the debtor no longer has possession or control of such funds.

⁶ *Id.* § 704(1).

Part III of this Article, therefore, examines the language of section 542(a) and the elements a trustee would need to establish in order to prevail on a section 542(a) turnover claim. In addition, Part III examines one of the leading cases siding with the debtor on the floating check controversy—*In re Pyatt*.⁷ This case holds that a debtor is not liable to the bankruptcy estate for the value of the funds if she lacks *current* possession of the actual funds at the time the trustee makes the demand for turnover. Several courts have followed the *Pyatt* decision. This Article argues that *Pyatt*'s reasoning is without merit and should not be followed.

Part IV argues that for a trustee to maintain a turnover action against the debtor, the trustee need only prove that the funds in the debtor's bank account are property of the estate and that the debtor had control over the funds at some point during the bankruptcy case. To satisfy these elements, Part IV uses the relevant provisions of the Uniform Commercial Code and further compares the pre-Code present "possession" requirement against the plain language of the current Bankruptcy Code.

Finally, while Part IV addresses the policy concerns that have been raised by several courts regarding the floating check controversy, it also raises a new approach that has not been addressed by the courts. Specifically, Part IV poses the question: which approach for recovering the funds is in the best interest of the estate and its creditors? Several courts that analyze the floating check controversy err in concluding that the crucial question is who is in the better position to prevent transfers by post-petition checks or which party is in the best position to

⁷ 486 F.3d 423 (8th Cir. 2007).

remedy the damages. Rather than focusing on these issues, this Article argues that the proper analysis is not necessarily which party is in a better position, but which method of recovering the funds provides the greatest return to the bankruptcy estate. The Bankruptcy Code requires the trustee to collect property of the estate as expeditiously as is compatible with the best interests of the parties in interest. As set forth in Part IV, a trustee has a choice of non-exclusive remedies. In some cases, recovering the funds from the debtor will provide the greatest return to creditors. But in other cases, recovering the funds from the payees might be more efficient and in the best interests of the estate. The point is that a trustee has options under the Bankruptcy Code and his choices are governed by the business judgment rule. This approach—and more specifically the trustee’s right to choose his remedy—is supported by the plain language of section 542(a) and comports with the trustee’s duties under the Bankruptcy Code.

II. OVERVIEW OF CHAPTER 7 BANKRUPTCY

A. Bankruptcy—In General

To fully understand the floating check controversy, one must understand general bankruptcy law. Bankruptcy law is federal law. “The substantive provisions of the Bankruptcy Reform Act of 1978 are found in Title 11 of the *United States Code* and are referred to as the ‘Bankruptcy Code’ or simply the

‘Code.’”⁸ The jurisdiction, venue, and administrative provisions appear in Title 28 of the *United States Code*.⁹

There are two overall forms of bankruptcy relief: (1) liquidation, and (2) rehabilitation or reorganization. The Bankruptcy Code divides the substantive law of bankruptcy into the following five chapters:¹⁰ (1) Chapter 7 cases, (2) Chapter 9 cases,¹¹ (3) Chapter 11 cases,¹² (4) Chapter 12 cases,¹³ and (5) Chapter 13

⁸ *Advanced Ch. Eleven Bankr. Prac.* § 1.4.

⁹ 28 U.S.C. §§ 1334 (jurisdiction); 1408-1410 (venue); 1411 (jury trial); 1452 (removal of cases from state courts); 151-155 (judgeship provisions); 156 (administrative/staff); 157 (referral of cases from district court to bankruptcy courts); 158 (appellate procedures, creation of bankruptcy appellate panels); 1930 (filing fees); 602 (creation of private panel of trustees); 581-589 (U.S. Trustees); and 959 (capacity of trustees to be sued).

¹⁰ 11 U.S.C. §§ 101-1532.

¹¹ Chapter 9 is available only to a municipality and only by means of a voluntary petition. 11 U.S.C. § 109(c).

¹² Chapters 11 and 13 deal generally with debtor rehabilitation or reorganization, not liquidation of the debtor’s assets. DAVID G. EPSTEIN, *BANKRUPTCY AND RELATED LAW IN A NUTSHELL*, 125 (7th ed. 2002). Typically, in a Chapter 11 or 13 case, creditors look to future earnings of the debtor, not the property of the debtor at the time of the bankruptcy petition, to satisfy their claims. The debtor usually retains its assets and makes payments to creditors pursuant to a court-approved plan. Chapter 11, like 7, is available to all forms of

cases.¹⁴ The availability of each of these chapters, however, is based on characteristics of the debtor at the time of filing.¹⁵

debtors—individuals, partnerships, and corporations. Chapter 13, on the other hand, can only be used by individuals with regular income who have unsecured, noncontingent, and liquidated debts of less than \$360,475 (adjusted periodically) and secured debts of less than \$1,081,400 (adjusted periodically). 11 U.S.C. § 109(e).

¹³ “Chapter 12 was added in 1986 because of what was perceived to be a major economic crisis in the farming community, particularly with respect to farms that had been held in the family over a long period of time. It was difficult or impossible for the farmer to use chapter 11 because the absolute priority rule that would require the farmer to give up its equity in the property to the mortgagee when loan payments went into default.” COLLIER ON BANKRUPTCY ¶ 541.01 at 541-10 (Alan N. Resnick & Henry J. Somme eds., 16th ed.).

¹⁴ 11 U.S.C. §§ 1301-1330.

¹⁵ The focus of this article is on Chapter 7 bankruptcy. Turnover actions under section 542(a) of the Bankruptcy Code are predominantly commenced by trustees in Chapter 7 bankruptcy and nearly every court to address the floating check controversy has done so in Chapter 7 cases. In Chapter 11 and 13 cases, the debtor is typically allowed to keep its property through a reorganization. Accordingly, the issue presented by this Article typically does not arise in Chapter 11 and 13 cases.

“Bankruptcy serves to mitigate the effects of financial failure.”¹⁶ For debtors who are individuals, the Bankruptcy Code affords the possibility of a fresh start through the bankruptcy discharge, as well as the ability to restructure their debts in certain circumstances. The Supreme Court of the United States has long stated that “[t]he principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor.”¹⁷

While state law focuses on individual action by a particular creditor and puts a premium on quick action by that creditor (*e.g.*, the first creditor to execute on the property wins), bankruptcy, on the other hand, compels more of a collective creditor action and emphasizes equality of treatment, rather than a sprint to the courthouse and the debtor’s assets.¹⁸ Indeed, after a debtor files for bankruptcy, a creditor cannot improve its position vis-à-vis other creditors by seizing assets of the debtor or taking further action against the debtor or the property of the estate to collect its claims.¹⁹ To that end, the filing of a bankruptcy petition automatically “stays,” that is “restrains, creditors from taking further action

¹⁶ COLLIER, *supra* note 13, at ¶ 101[1] at 1-4.

¹⁷ *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007); *see also Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (stating that “[o]ne of the primary purposes of the bankruptcy act is to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh.”).

¹⁸ DAVID G. EPSTEIN, *BANKRUPTCY AND RELATED LAW IN A NUTSHELL*, 120 (6th ed. 2002).

¹⁹ *Id.*

against the debtor, the property of the debtor, or to property of the estate to collect their claims.”²⁰

The automatic stay is one of the most important protections in the Bankruptcy Code.²¹ Obtaining the protections of the automatic stay is often the primary reason for filing a bankruptcy petition. Congress, in enacting the Bankruptcy Code, was quite clear as to the purpose of the stay:

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan or simply to be relieved of the financial pressures that drove him into bankruptcy.²²

The stay is also fundamental to other policies underlying the Bankruptcy Code: equal distribution to creditors of equal priority and orderly administration

²⁰ *Id.* at 149

²¹ The automatic stay is so named because it becomes effective automatically upon the filing of a bankruptcy petition. The debtor does not have to do anything to make it effective. The creditor has the burden of moving to get the stay lifted. It is no excuse that the creditor did not have notice of the filing before the action was taken. The action will still be set aside as void. *See, e.g., Ellis v. Consol. Diesel Elec. Corp.*, 894 F.2d 371 (10th Cir. 1990) (holding summary judgment void where entered prior to lifting automatic stay).

²² House Report No. 95-595, 95th Cong., 1st Sess. 340-2 (1977); Senate Report No. 95-989, 95th Cong. 2nd Sess. 49-51 (1978).

of the estate.²³ It ends the state law policy of a “race to the court house” or “first come, first serve” and replaces it with the Bankruptcy Code policy of equal treatment to creditors similarly situated.²⁴

The automatic stay is particularly significant in Chapter 7 bankruptcy cases and in relation to the floating check controversy. Indeed, if a debtor files a Chapter 7 petition, the appointed Chapter 7 trustee needs time to collect the property of the estate (e.g., funds in the debtor’s bank account) and make pro-rata distributions to creditors. Continued creditor actions against the debtor and property of the estate would inevitably interfere with the trustee’s orderly bankruptcy administration.

B. Chapter 7 Bankruptcy

²³ See *In re Curtis*, 40 B.R. 795 (Bankr. D. Utah 1984).

²⁴ Generally, the automatic stay remains in effect until the particular property is no longer property of the bankruptcy estate, entry of an order granting relief from the stay, the case is closed or dismissed, or a discharge is granted or denied. 11 U.S.C. § 362(c), (d). Lenders have attempted to circumvent the automatic stay by including provisions within loan documents that protect them from the automatic stay. Courts have generally been loath to accept such provisions. See, e.g., *In re Ames Dep’t Stores, Inc.*, 115 B.R. 34 (Bankr. S.D.N.Y. 1990). Section 362 sets forth the categories of actions that are stayed by the filing of a bankruptcy petition.

Chapter 7 of the Bankruptcy Code is entitled “Liquidation” or “Straight Bankruptcy” and is the most common chapter used by debtors. Its purpose is to provide debtors with a “fresh start.” In a Chapter 7 case, a trustee is appointed and his duty is to collect the nonexempt property of the debtor, convert that property to cash, and distribute that cash to creditors in accordance with the distribution scheme of the Bankruptcy Code.²⁵ Essentially, the debtor gives up all nonexempt property she owns at the time of the filing of the bankruptcy petition in exchange for a discharge of all her debts.²⁶

In a very simplified overview, the basic stages of a Chapter 7 case are: (1) the Chapter 7 petition is filed; (2) the filing of the petition results in the stay of creditor collection activity²⁷ and the appointment of a trustee to administer the case;²⁸ (3) the debtor exercises exemption rights with respect to her property;²⁹ (4)

²⁵ 11 U.S.C. § 704.

²⁶ The right to a discharge is not absolute, and some types of debt are not discharged. For example, if the debtor has committed some “bad act” enumerated in section 727 of the Bankruptcy Code, the debtor may not be entitled to any discharge. 11 U.S.C. § 727. Moreover, certain enumerated debts set forth in section 523(a) are non-dischargeable. 11 U.S.C. § 523(a). Additionally, bankruptcy discharge does not extinguish consensual liens on the debtor’s property. *In re Young*, 04-32102, 2007 WL 1159952, at * 2 (Bankr. S.D. Tex. 2007).

²⁷ 11 U.S.C. § 362(a).

²⁸ *Id.* § 701(a).

any property available for distribution to the debtor's creditors is collected and sold or liquidated by the trustee;³⁰ (5) the proceeds from the sale of the property are used to pay administration expenses and the claims of the debtor's creditors according to the Bankruptcy Code's priority scheme;³¹ (6) the debtor *may* be discharged from any remaining pre-petition debts³² that are not exempted from discharge.³³

1. The Chapter 7 Petition

The majority of Chapter 7 cases are filed voluntarily by the debtor.³⁴ The process for filing is fairly simple. The debtor files the petition, statement of financial affairs, and schedule of assets and liabilities, all upon prescribed forms. Consumer debtors, but not other debtors selecting Chapter 7, are required to pass an income threshold referred to as the "means test."³⁵ The means test is a formula

²⁹ *Id.* § 522.

³⁰ *Id.* § 704.

³¹ *Id.* § 726.

³² *Id.* § 727.

³³ *Id.* § 523.

³⁴ *Id.* § 301.

³⁵ *Id.* § 707(b).

designed to keep bankruptcy filers with higher incomes—or those that could feasibly fund a Chapter 11 or 13 plan—from filing for Chapter 7.³⁶

The official forms and schedules list information required of the debtor about present and past financial condition. “Much additional information is required, some certified under oath by the debtor.”³⁷ These include, among other things:

³⁶ *Id.* Interestingly, only filers with primarily consumer debts—not business debts—need to satisfy this test. *Id.* In other words, one can have a very high income and still qualify for Chapter 7 bankruptcy if one’s debts can be classified as “business debts.” Under section 101(8) of the Bankruptcy Code, a consumer debt is defined as a debt “incurred by an individual primarily for a personal, family, or household purpose.” 11 U.S.C. § 101(8). In determining whether debt is for a “personal, family, or householder purpose” under section 101(8), courts look to the purpose for which the debt was incurred. *In re Stewart*, 215 B.R. 456, 465 (B.A.P. 10th Cir. 1997). Debt incurred for a business venture or with a profit motive does not fall into the category of debt incurred for “personal, family, or household purposes.” *Id.* Most courts conclude that the ratio of the dollar amount of consumer debt to nonconsumer debt should be controlling in determining whether the indebtedness is primarily consumer debt for purposes of 707(b). *In re Kelly*, 841 F.2d 908, 913 (9th Cir. 1998). Thus, if over 50% of an individual’s total debt arises out of a personal guaranty agreement, which was executed for a business venture or profit motive, section 707(b) would not apply and the individual could file for Chapter 7 protection. *Id.*

³⁷ 1 *Bankruptcy Law Fundamentals* § 1:8, Richard I. Aaron, (June 2011).

Identity documents; prepetition financial instruction by an approved service; any budget payment plan worked out; copies of 'payment advices' such as paycheck stubs for the preceding 60 days; itemized net monthly income; 12-month projection of income or expenses reasonably expected; intentions for redemption or reaffirmation as to collateral held under a purchase money security agreement; current tax returns; and interest in any I.R.A.³⁸

A Chapter 7 debtor is also required to turn over bank records showing the debtor's account balance on the day of the bankruptcy petition.³⁹ Indeed, section 521 of the Bankruptcy Code requires the debtor to "surrender to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate[.]"⁴⁰ Failure by the debtor to comply with these debtor duties and supply this information within the appropriate time limits may result in dismissal of the bankruptcy case.⁴¹

2. *The Chapter 7 Trustee and His Duties*

In every Chapter 7 case, a trustee is appointed. The Chapter 7 trustee is an impartial person representing the collective interest of the debtor's creditors. A Chapter 7 trustee is active, controlling and administering the bankruptcy estate. According to section 323 of the Bankruptcy Code, the trustee is "the

³⁸ *Id.*

³⁹ 11 U.S.C. § 521(4).

⁴⁰ *Id.*

⁴¹ 11 U.S.C. § 707.

representative of the estate.”⁴² The Trustee is essentially the successor to the debtor to collect and reduce to money the property of the estate. The Trustee also represents the creditors. In that capacity, he may exercise rights that would have belonged to creditors before the beginning of the bankruptcy case. Some of the Trustee’s responsibilities include, among others, the duty to:

- (1) Collect and reduce to money the property of the estate and attempt to close the estate as soon as possible;
- (2) Account for all property of the estate;
- (3) Investigate the financial affairs of the debtor;
- (4) If necessary, examine proofs of claim and object to the allowance of claims;
- (5) If advisable, oppose the discharge of the debtor;
- (6) Furnish information concerning the estate and the administration of the estate;
- (7) File periodic operating reports of the operation of the debtor’s business; and
- (8) Submit a final report and file with the court a final accounting of the administration of the estate.⁴³

Another duty of the Trustee is to conduct the first meeting of creditors under title 11, section 341 of the United States Code, oftentimes referred to as the “341 Meeting.” The debtor is required to appear at the 341 Meeting and submit to examination under oath.⁴⁴ The scope of the examination at the 341 Meeting is very broad. Indeed, “[t]he purpose of the examination is, generally, to ascertain the status of the debtor’s assets, liabilities; to determine whether any avoidable or

⁴² 11 U.S.C. § 323.

⁴³ *Id.* § 704.

⁴⁴ *Id.* § 343.

improper transfers have occurred or whether assets are being concealed, or whether there are grounds for objection to exemptions or discharge.”⁴⁵

With the opening of the bankruptcy estate, the Trustee should begin to promptly assemble the property belonging to the estate. This may include taking possession of the debtor’s known bank accounts and books and records, seizing vehicles and other property, changing locks at the debtor’s premises, and reviewing the debtor’s schedules for non-exempt assets and potential avoidance claims. In some cases, the Trustee may need to collect property from the hands of third persons, or perhaps noncompliant debtors in possession of estate property. One of the most basic collection methods is the trustee’s turnover power under section 542(a) of the Bankruptcy Code.

III. SECTION 542(A) TURNOVER ACTIONS AND CASE LAW ADDRESSING THE FLOATING CHECK CONTROVERSY

To understand the floating check issue, one must understand the inception of “turnover” actions. Prior to the enactment of the Bankruptcy Code, turnover procedures were not prescribed by statute, but rather were considered “judicial innovation[s]” derived from the notion that the courts were empowered under the

⁴⁵ 842 PLI/Comm, *Step-By-Step Procedure in Chapter 7 Case*, Hon. Carla E. Craig (Nov. 2002).

Bankruptcy Act (which governed from 1898⁴⁶ to 1978) to “cause the estates of the bankruptcy to be collected.”⁴⁷ But the jurisdiction of the bankruptcy court’s ability to recover property of the estate was limited. Indeed, “a court’s authority to compel turnover under the former Act was limited to only its own summary jurisdiction over the estate’s actual property.”⁴⁸ The enactment of the Bankruptcy Code, however, expanded the court’s authority to compel turnover and recover property of the estate.⁴⁹

In 1978, with the enactment of the Bankruptcy Code, a substantive cause of action for turnover of property of the estate was created by section 542. This section allows a trustee to recover property of the estate in possession, custody, or control of any entity. The statute provides, in relevant part, as follows: [A]n entity⁵⁰ . . . in possession, custody, or control, during the case, of property [of the

⁴⁶ The Bankruptcy Act of 1898 was significantly amended by the Bankruptcy Act of 1938. Edward S. Adams, Daniel A. Farber, *Beyond the Formalism Debate: Expert Reasoning, Fuzzy Logic, and Complex Statutes*, 52 Vand. L. Rev. 1243, 1320 (1999).

⁴⁷ *Maggio v. Zeitz (In re Luma Camera Serv., Inc.)*, 333 U.S. 56, 61 (1948).

⁴⁸ *In re Fleming*, 424 B.R. 795, 804 (W.D. Mich. 2010).

⁴⁹ *In re Adams*, 453 B.R. 774, 777–78 (Bankr. D. Ala. 2011).

⁵⁰ The term “entity” under the Bankruptcy Code “includes person, estate, trust, governmental unit, and United States Trustee.” 11 U.S.C. § 101(15). Thus, nearly everyone is subject to the powers of section 542(a) of the Bankruptcy Code. *See In re Sawyer*, 324 B.R. 115, 122 (Bankr. D. Ariz. 2005). Some debtors

estate] . . . shall deliver to the trustee . . . such property or the value of such property[.]⁵¹

The purpose of title 11, section 542 of the United States Code is “to expand the trustee’s power to ‘bring into the estate property . . . at the time the bankruptcy proceedings commenced,’ ensuring that a broad range of property is included in the estate in order to promote the congressional goal of encouraging reorganizations.”⁵² This turnover power even “reaches property in the hands of

have argued that section 542(a) is inapplicable by asserting that the word “entity” cannot include debtors since the word “debtor” appears separately in the same subsection. This argument has failed. As noted by one court, “‘Entity,’ which is a defined term, is a set of things, if you will, that includes all individuals, partnerships, corporations, estates, trusts, governmental units, and the United States Trustee. ‘Debtor,’ in turn, is a subset of this larger group that includes only individuals, partnerships, corporations, and municipalities. Consequently, it follows that an individual like [the debtors] can be both an ‘entity’ and a ‘debtor’ under the Code without contradiction. Or, conversely, it does not follow, as the [debtors] would have it, that an individual debtor cannot also be an entity within the meaning of the Code.” *In re Fleming*, 424 B.R. 795, 801 (Bankr. W.D. Mich. 2010) (internal citations omitted).

⁵¹ 11 U.S.C. § 542(a).

⁵² *Braunstein v. McCabe*, 571 F.3d 108, 116 (1st Cir. 2009) (quoting *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 (1983)).

secured creditors.”⁵³ Indeed, a turnover action by a trustee “invokes the court’s most basic equitable powers to gather and manage property of the estate.”⁵⁴

A turnover proceeding may be brought as an adversary proceeding,⁵⁵ by service of complaint,⁵⁶ or by motion as a contested-matter proceeding if it is against the debtor.⁵⁷ Although the Bankruptcy Code contains no express time limitation for the commencement of a turnover proceeding, such an action may nevertheless be time-barred.⁵⁸ An order granting or denying a trustee’s turnover

⁵³ COLLIER, *supra* note 13, at ¶ 542.01 at 542-3.

⁵⁴ *Braunstein*, 571 F.3d 108, 122.

⁵⁵ Rule 7001(1) of the Federal Rules of Bankruptcy Procedure includes in the list of adversary proceedings “a proceeding to recover money or property, other than a proceeding to compel the debtor to deliver property to the trustee.” Fed. R. Bank. P. 7001(1). Thus, a trustee is entitled to proceed against the debtor via motion since the rule states that a proceeding to recover money or property is an adversary proceeding *unless* it is a proceeding to compel the debtor to turn over property of the estate to the trustee.

⁵⁶ *Id.* 7003.

⁵⁷ *See, e.g., In re Toledano*, 299 B.R. 284 (Bankr. S.D. N.Y. 2003) (holding that Rule 7001 specifically allows a trustee to compel a debtor to turnover property of the estate by motion rather than by adversary proceeding).

⁵⁸ *See, e.g., In re Fleming*, 424 B.R. 795 (W.D. Mich. 2010) (holding that the trustee’s delay in seeking to compel turnover of a tax refund that was included, at least in part, in property of the estate, until more than three years after discovering

request is a final order within the meaning of title 28, section 158 of the United States Code and, therefore, the district court has jurisdiction to hear any appeal from an order granting or denying such a request.⁵⁹ If a party, including a debtor, fails to comply with a turnover order, they are guilty of civil contempt and may be punished.⁶⁰ Furthermore, a debtor's failure to turn over property and comply with the trustee's demand can also result in the revocation of her discharge.⁶¹

its existence, barred the trustee from holding the debtors liable under section 542(a) for their premature expenditure of their refund.). As the *Fleming* court observed, “[b]ankruptcy courts are frequently described as courts of equity and laches is certainly an equitable defense. But section 105(a) itself empowers bankruptcy courts to ‘issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.’ Moreover, the Supreme Court and the Sixth Circuit have held that the Bankruptcy Code takes precedent over equity in determining the bankruptcy court’s authority to act. Therefore, while laches may seem like a reasonable approach, the court concludes that it is better to address Trustee’s delay with the tools already provided by Section 105(a).” *Id.* at 805.

⁵⁹ See, e.g., *In re Prof. Ins. Mng.*, 285 F.3d 268, 281 (3d Cir. 2002) (stating that a turnover order is widely regarded as a final order for purposes of appeal).

⁶⁰ See, e.g., *Maggio v. Zeitz*, 333 U.S. 56 (1948) (discussing contempt for failure to comply with a turnover order); *In re Shore*, 193 B.R. 598 (S.D. Fla. 1996) (affirming contempt order for failure to comply with turnover order). Under section 105 of the Bankruptcy Code, the bankruptcy court “may issue any order,

process, or judgment that is necessary or appropriate to carry out the provisions of” Title 11. 11 U.S.C. § 105(a). Section 105(a) “authorizes bankruptcy courts to impose sanctions for civil contempt to compel compliance with a court order or compensate parties for losses caused by noncompliance.” *Scrivner v. Mashburn (In re Scrivner)*, 535 F.3d 1258, 1265 n.3 (10th Cir. 2008) (citing *Mountain Am. Credit Union v. Skinner (In re Skinner)*, 917 F.2d 444, 447 (10th Cir. 1990)).

“The standard for finding a party in civil contempt is well settled: The moving party has the burden of showing by clear and convincing evidence that the contemnors violated a specific and definite order of the court.” *Knupfer v. Lindblade (In re Dyer)*, 322 F.3d 1178, 1190–91 (9th Cir. 2003). In *Hercules Enterprises Inc.*, the court awarded civil sanctions, including attorneys’ fees, when the debtor’s principal failed to turn over property of the estate. *See In re Hercules Enterprises, Inc.*, 387 F.3d 1024, 1027–28 (9th Cir. 2004). The defendant in *Hercules* operated a gymnasium with several pieces of exercise equipment. *Id.* at 1026. When the defendant removed the equipment from the gym, the trustee moved the court to compel its return. *Id.* The court granted the motion and ordered the defendant to turn over the equipment to the Trustee. *Id.* When the defendant still failed to turn over the equipment, the court ordered that he be incarcerated as a coercive sanction until he did so. *Id.* at 1028. The court further ordered the defendant to pay to the trustee \$20,883.00, “an amount approximating the fees and costs incurred by him as the result of [the defendant’s] misconduct.” *Id.* at 1027.

In analyzing a motion for turnover pursuant to section 542(a), “[t]he first question is what precisely constitute[s] property of the bankruptcy estate on the date of filing.”⁶² If the property subject to turnover is not property of the debtor’s bankruptcy estate, the trustee’s section 542(a) turnover action will undoubtedly fail.⁶³

A. *Property of the Estate*

“Section 541 embodies the essence of the Bankruptcy Code. It creates the bankruptcy estate, which consists of all of the property that will be subject to the jurisdiction of the bankruptcy court.”⁶⁴ “It is from this central core of estate

⁶¹ See, e.g., *In re Davitch*, 336 B.R. 241 (Bankr. W.D. Pa. 2006) (discussing a revocation of debtor’s discharge for failure to turn over property of the estate or disclose property of the estate).

⁶² *In re Ruiz*, 455 B.R. 745, 748 (B.A.P. 10th Cir. 2011).

⁶³ In seeking the entry of a turnover order, the burden is on the trustee to show that the property or proceeds are part of the bankruptcy estate. *Maggio v. Zeitz*, 333 U.S. 56, 64 (1948); *In re Joe Necessary & Son, Inc.*, 475 F. Supp. 610, PIN (W.D. Va. 1979). The general rule is that “[t]he trustee succeeds only to such rights as the bankrupt possessed; and the trustee is subject to all claims and defenses which might have been asserted against the bankrupt but for the filing of the petition.” *Bank of Marin v. England*, 385 U.S. 99, 101 (1966).

⁶⁴ COLLIER, *supra* note 13, at ¶ 541.01 at 541-10.

property that the debtor’s creditors will be paid.”⁶⁵ Congress’ intent was to make the bankruptcy estate as inclusive as possible⁶⁶ and to construe it generously.⁶⁷ Indeed, section 541(a)(1) of the Bankruptcy Code provides that the property of the estate includes, but is not limited to, “*all legal or equitable interests of the debtor* in property as of the commencement of the [bankruptcy] case” wherever located and by whomever held.⁶⁸ “It would be hard to imagine language that would be more encompassing.”⁶⁹ Section 541(b) enumerates those items that are specifically excluded from being property of the estate. These exclusions are narrow.⁷⁰

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *In re* Montgomery, 224 F.3d 1193, 1194 (10th Cir. 2000).

⁶⁸ *See* 11 U.S.C. § 541(a)(1) (emphasis added); *In re* Marshall, 550 F.3d 1251, 1255 (10th Cir. 2008).

⁶⁹ COLLIER, *supra* note 13, at ¶ 541.01 at 541-10.

⁷⁰ “Enumerated exclusions consist of powers that the debtor may exercise solely for another’s benefit, any interest of the debtor as lessee under a lease or nonresidential real property after the expiration of the lease term, the debtor’s eligibility to participate in Higher Education programs or accreditation or licensure status as an educational institution, certain interests in liquid or gaseous hydrocarbons, funds placed in a Coverdell Education Savings Account, the debtor’s interest in funds used to purchase certain tuition benefits, the debtor’s interest in amounts withheld from wages or contributed by the debtor to certain

“Even though section 541 provides the framework for determining the scope of the debtor’s estate and what property will be included in the estate, it does not provide any rules for determining whether the debtor has an interest in property in the first place.”⁷¹ The Supreme Court of the United States has stated, “Congress has left the determination of property rights in the assets of the bankruptcy’s estate to state law Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.”⁷²

Section 541(a) also includes any property recovered by the trustee using the turnover powers conferred by section 542. Indeed, “property of the estate,” subject to turnover, was intended by Congress to include a broad range of property.⁷³ The United States Supreme Court has stated: “Although these statutes [, sections 542(a), 363(a) and (b), and 541(a)(1),] could be read to limit the estate to those ‘interests of the debtor in property’ at the time of the filing of the petition,

employee benefit or deferred compensation plans, the debtor’s interest in property subject to possessory pledges to certain licensed lenders, such as pawnbrokers, and certain cash or equivalent proceeds from the sale of a money order made within fourteen days prior to the commencement of the case if the proceeds are required to be segregated from the debtor’s other property.” *Id.* at 541-10 to 11.

⁷¹ *Id.*

⁷² *Butner v. United States*, 440 U.S. 48, 54–55 (1979).

⁷³ *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 (1983).

we view them as a definition of what is included in the estate, rather than as a limitation.”⁷⁴

With respect to funds in a debtor’s bank account on the petition date, nearly all courts that have addressed the floating check issue—even those siding with the debtor—agree that if the funds are present in the debtor’s account, such funds are property of the debtor’s bankruptcy estate.⁷⁵ However, a small minority of courts hold that the funds themselves are not property of the estate, but rather it is the debtor’s right to collect the funds from the bank that constitutes property of the estate.⁷⁶ As stated by one court, the debtor “did not own the money in the account, but was merely a creditor of Merrill Lynch. Property of the debtor is defined to include ‘all legal or equitable interests of the debtor,’ § 541(a)(1), and obviously includes the interest that a depositor has in the money account, more precisely the money owed him by the bank by virtue of the account.”⁷⁷ This minority view is flawed because it attempts to narrow the scope of section 541 (i.e., property of the

⁷⁴ *Id.* at 203.

⁷⁵ *See infra* note 95 (citing cases).

⁷⁶ *In re Ruiz*, 440 B.R. 197, 201 (Bankr. D. Utah 2010), *overruled by In re Ruiz*, 455 B.R. 745 (B.A.P. 10th Cir. 2011) (noting that “Zions Bank was in possession, custody and control of the funds on deposit and the funds belonged to Zions Bank on the petition date. The Debtors were in possession, custody, and control of a promise to pay from the bank to the Debtors.”)

⁷⁷ *In re USA Diversified Products*, 100 F.3d 53, 55 (7th Cir. 1996).

estate). In at least one decision addressing this issue,⁷⁸ the court's narrow holding that the estate's interest in the checking account amounted to nothing more than a beneficial interest in the bank's promise to pay the funds held in the account (as opposed to the money in the account), was derived from language contained in the United State Supreme Court's opinion in *Citizens Bank of Maryland v. Strumpf*.⁷⁹

In *Strumpf*, a debtor had both a checking account and a delinquent loan with a creditor bank on the petition date.⁸⁰ When the bankruptcy petition was filed, the bank placed an administrative hold on that part of the funds contained in the checking account required to offset any pre-petition debt that the debtor owed the bank on the loan.⁸¹ The debtor brought an action against the bank, alleging that the bank had violated the automatic stay because the "administrative hold" was actually an improper "setoff" of the debtor's funds in violation of section 362(a)(7)⁸² of the Bankruptcy Code.⁸³ The Supreme Court held that the bank's

⁷⁸ *In re Ruiz*, 440 B.R. 197 (Bankr. D. Utah 2010), *overruled by In re Ruiz*, 455 B.R. 745 (B.A.P. 10th Cir. 2011).

⁷⁹ 516 U.S. 16 (1995).

⁸⁰ *Id.* at 17.

⁸¹ *Id.*

⁸² The automatic stay prevents "the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor" 11 U.S.C. § 362(a)(7).

⁸³ *Strumpf*, 516 U.S. at 17–18.

actions did not constitute a setoff, and thus it had not violated the automatic stay.⁸⁴

Following that holding, the Supreme Court also briefly dismissed the debtor's contentions that the bank had violated the automatic stay, noting that the bank did not actually take possession of any of the debtor's property or exercise control over debtor's property.⁸⁵ Rather, the Court held that the bank merely failed to perform its promise to pay the debtor the funds held in the account.⁸⁶

From the *Strumpf* holding, the lower court in *Ruiz* took a very narrow view, holding:

Strumpf makes clear that funds held on deposit in a debtor's bank account do not belong to the debtor and do not belong to the bankruptcy estate. Funds held by a bank consists of nothing more or less than a promise to pay, from the bank to the depositor . . . [Debtors' bank] was in possession, custody and control of the funds on deposit and the funds belonged to [Debtors' bank]. The Debtors were in possession, custody, and control of a promise to pay from the bank to the Debtors.⁸⁷

In rejecting this holding (and disagreeing with other similar holdings), the BAP of the Tenth Circuit stated that although the language contained in *Strumpf* does "facially support Debtors' position, the context of that case is entirely

⁸⁴ *Id.* at 19–20.

⁸⁵ *Id.* at 19–20.

⁸⁶ *Id.* at 21 (noting that a bank account "consists of nothing more or less than a promise to pay, from the bank to the depositor").

⁸⁷ *In re Ruiz*, 440 B.R. 197, 201 (Bankr. D. Utah 2010), *overruled by In re Ruiz*, 455 B.R. 745 (B.A.P. 10th Cir. 2011).

different from the case currently before this Court.”⁸⁸ The Tenth Circuit BAP’s reason for rejecting the *Strumpf* holding in the context of the floating check issue was that *Strumpf* “solely involved the automatic stay and the relationship between the bank and the debtor in that context. The issue of what constituted property of the estate under § 541 was neither argued nor decided.”⁸⁹ For that reason, the Tenth Circuit BAP stated that the “language in *Strumpf* is not dispositive under the facts, or the [floating check] issue presented, in this case.”⁹⁰

The Tenth Circuit BAP further held that the relationship between the bank and the debtors was “considerably different than the typical debtor-creditor relationship that existed in *Strumpf*.”⁹¹ Indeed, the “[d]ebtors maintained the right to withdraw the funds in their account at any time, to direct [their bank] to deliver the funds to any third party, or to leave the funds on deposit.”⁹² The court further concluded that “although [the bank] did make a promise to pay the funds in the account to the debtors, the checking account constituted much more than that promise and Debtors’ rights to those funds exceeded those of a typical creditor.”⁹³

Finally, the Tenth Circuit BAP recognized that the scope of section 541 (i.e., property of the estate) is broad “and should be generously construed” and that

⁸⁸ *In re Ruiz*, 455 B.R. 745, 749 (B.A.P. 10th Cir. 2011).

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

“the bankruptcy court’s attempts to narrow the scope of § 541 in relation to funds on deposit in a checking account does not satisfy the standard the Court must apply when considering § 541.”⁹⁴ With that, the Tenth Circuit BAP adopted the “prevailing view of *nearly every court* to consider this issue by holding that the funds in [a Debtor’s bank] account, rather than merely the promise to pay over those funds, constitute . . . property of the bankruptcy estate.”⁹⁵

⁹⁴ *Id.*

⁹⁵ *Id.*; see also *In re Pyatt*, 486 F.3d 423, 427 (8th Cir. 2007) (“the funds transferred by the [pre-petition] checks are property of the estate”); *In re Brubaker*, 426 B.R. 902, 905 (Bankr. M.D. Fla.2010), *aff’d*, 443 B.R. 176 (M.D.Fla.2011) (“both schools [of thought] agree that the funds are property of the estate”); *Yoon v. Minter–Higgins*, 399 B.R. 34, 42–44 (N.D. Ind. 2008) (holding money in the debtors’ bank account on the petition date became property of the estate); *In re Parsons*, No. 05–00321, 2006 WL 3354513, at *1 (Bankr. S.D. Ind. Nov. 17, 2006) (“Funds on deposit in a debtor’s checking account . . . on the petition date are property of the bankruptcy estate.”); *In re Schoonover*, No. 05–43662–7, 2006 WL 3093649, at *2 (Bankr. D. Kan. Oct. 30, 2006) (“This Court has located eight decisions that address this issue. As a threshold matter, all eight decisions agree that the money [in the checking account] is property of the estate.”); *In re Spencer*, 362 B.R. 489, 491 (Bankr. D. Kan. 2006) (“the funds remained in [the debtors’] possession and control at the date of the petition, were property of the estate, and were therefore subject to turnover.”); *In re Sawyer*, 324 B.R. 115, 121 (Bankr. D. Ariz. 2005) (“Indeed, a review of Section 541 provides

While the issue of what constitutes “property of the estate” is rather clear-cut, the second element of a section 542(a) turnover claim—“possession, custody or control” of that property—presents a thornier issue and one that has been the subject of much debate.

B. Possession, Custody or Control of Property of the Estate

that the collected funds in the Debtor’s account became property of the bankruptcy estate either pursuant to Section 541(a)(1) or (a)(2)”; *In re Taylor*, 332 B.R. 609, 611 (Bankr. W.D. Mo. 2005) (“property of the estate includes the funds in the account”); *In re Dybalski*, 316 B.R. 312, 316 (Bankr. S.D. Ind. 2004) (“the Funds are property of the estate”); *In re Parker*, No. 05-17912, 2008 WL 906570, at *4 (Bankr. N.D. N.Y. April 3, 2008) (“the court concludes that on the date the Debtor’s bankruptcy petition was filed, the entire \$3,275.94 balance in the Trustco Account became an asset of the Debtor’s bankruptcy estate under § 541(a)(1); *In re Anderson*, 410 B.R. 289, 295 (Bankr. W.D. Mo. 2009) (“Funds in the debtors’ checking account, upon which no checks have been written as of the date of the petition, are property of the estate.”); *In re Henson*, 449 B.R. 109, 112 (Bankr. D. Nev. 2011) (“The bankruptcy court held that the checks written pre-petition by Debtor became property of the estate because they had not been honored when Debtor filed for bankruptcy.”); *In re Maurer*, 140 B.R. 744, 746 (D. Minn. 1992) (holding that pre-petition checks remain property of the estate until honored).

After a court determines that the subject property is “property of the estate,” the next question in analyzing a trustee’s turnover request is whether the party subject to the turnover action had “possession, custody, *or* control” of that property “during the case,” such that they can be required to turn over the property, or its value, to the trustee pursuant to section 542(a).⁹⁶ “While it is true that the phrase ‘possession, custody, or control’ is not defined in the Code, reading the phrase in the context with the language of § 541 helps clarify its meaning and purpose.”⁹⁷ Section 541 provides, in relevant part, that “[t]he commencement of a case . . . creates an estate. Such estate is comprised of all the following property, *wherever located and by whomever held*: (1) . . . *all legal or equitable interests* of the debtor in property as of the commencement of the case.”⁹⁸ “That language . . . indicates the very broad scope of a bankruptcy estate.”⁹⁹ Indeed, “Congress drafted the sweeping language of §§541 and 542 deliberately to grant broad powers to an estate and its trustee.”¹⁰⁰

A handful of courts have held that funds in the debtor’s account as of the bankruptcy filing, which were dissipated post-petition, are not subject to turnover

⁹⁶ § 542(a) (emphasis added).

⁹⁷ *In re U.S.A. Diversified Products, Inc.*, 196 B.R. 801, 808 (N.D. Ind. 1996).

⁹⁸ 11 U.S.C. § 541(a)(1) (emphasis added).

⁹⁹ *In re U.S.A. Diversified Products, Inc.*, 196 B.R. 801, 808 (N.D. Ind. 1996).

¹⁰⁰ *Id.*

by the debtor pursuant to section 542(a), even though the funds are property of the debtor's bankruptcy estate. These courts hold that an entity cannot be compelled to turn over property that is no longer within its "possession, custody, or control."¹⁰¹

The leading case on this issue is in *In re Pyatt*.¹⁰² There, when the debtor filed for Chapter 7 relief, there was \$1,938.76 in his checking account.¹⁰³ Post-petition, and before the trustee was appointed and could even make a turnover demand, the bank honored several pre-petition checks written to creditors, leaving all but \$300 of the \$1,938.76 in the debtor's account.¹⁰⁴ The debtor's bankruptcy schedules reflected this asset in the sum of \$300, which debtor believed would be the amount left in his account after all the checks cleared.¹⁰⁵ At the 341 Meeting, however, the trustee learned of the true amount still in the account as of the petition date, not considering the checks that were honored subsequent to filing, and demanded turnover pursuant to section 542(a).¹⁰⁶ The bankruptcy court

¹⁰¹ See, e.g., *In re Pyatt*, 486 F.3d 423 (requiring current possession); *In re Henson*, 449 B.R. 109, 112–13 (D. Nev. 2011) (same); *In re Falzerano*, 454 B.R. 81, 86 (B.A.P. 8th Cir. 2011) (same); *In re Anderson*, 410 B.R. 289 (Bankr. W.D. Mo. 2009) (same).

¹⁰² 486 F.3d 423 (8th Cir. 2007).

¹⁰³ *Id.* at 425.

¹⁰⁴ *Id.* at 426.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

concluded that because the assets represented by the checks were still in the debtor's account as of the date of his filing, the trustee was allowed to compel turnover under section 542(a).¹⁰⁷

The debtor appealed to the Eighth Circuit BAP, which reversed.¹⁰⁸ The panel majority concluded that the trustee was in a "better position" to recover the funds paid out by a bank to third parties after the debtor's filing because the trustee was authorized to avoid post-petition transfers pursuant to section 549 of the Bankruptcy Code.¹⁰⁹ The court concluded that if the trustee were to recover the transferred funds, the claims paid by the checks could be reinstated and the

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* Section 549 of the Bankruptcy Code allows a trustee to avoid unauthorized post-petition transfers, subject to certain exceptions. The purpose of section 549 is to allow the trustee to avoid specified post-petition transfers that have depleted the bankruptcy estate. COLLIER, *supra* note 13, at ¶ 541.01 at 541-10. "Examples of postpetition transfers not authorized by the Bankruptcy Code or the bankruptcy court that are recoverable by the trustee are payments to prepetition creditors, including payments of penalties to a state agency, the placement of judgment liens upon the debtor's property, a deduction made from a debtor's wages to pay a credit union debt, a payment of a postpetition loan and a bank's setoff of funds to apply to prepetition indebtedness." *Id.* With respect to the floating check issue, a trustee could clearly recover the funds directly from the payees of the checks by pursuing avoidance actions under § 549.

recovered funds could be distributed equally among all creditors.¹¹⁰ The concurring opinion disagreed that the trustee was in a better position to collect the funds, but argued that section 542(a) does not authorize any procedure used by the trustee because the debtor *no longer had control of the funds* and, therefore, could not be required to turn them over.¹¹¹

The Eighth Circuit affirmed, noting that section 542(a) of the Bankruptcy Code requires any entity that is in possession, custody, or control “during the case,” of property of the estate to turn it over to the trustee.¹¹² The Eighth Circuit in *Pyatt* did not dispute that the funds transferred by the checks were property of the estate.¹¹³ However, the Eighth Circuit concluded that the words “during the case” fails to acknowledge the other language of section 542(a).¹¹⁴ While section 542(a) imposes an obligation on any entity who comes into “possession, custody, or control” of property of the estate after the bankruptcy petition is filed to deliver it to the trustee, it says nothing about whether that obligation continues *after* possession, custody or control cease, and does not specify whether an entity that lacks control may properly be subject to a motion to compel turnover.¹¹⁵ The *Pyatt* court also relied on pre-Code practice and the 1948 Supreme Court decision in

¹¹⁰ *Pyatt*, 486 F.3d at 426.

¹¹¹ *Id.*

¹¹² *Id.* at 427.

¹¹³ *Id.*

¹¹⁴ *Id.* at 428.

¹¹⁵ *Id.*

Maggio v. Zeitz,¹¹⁶ which held that possession or control of the property by a party at the time of the turnover proceeding is required to compel turnover.¹¹⁷ Several courts have followed, and to continue to follow, the *Pyatt* holding.¹¹⁸ *Pyatt's*

¹¹⁶ 333 U.S. 56 (1948).

¹¹⁷ *Id.* at 61.

¹¹⁸ *See, e.g., In re Henson*, 449 B.R. 109, 112–13 (D. Nev. 2011) (stating that “[w]e agree with the reasoning in *Pyatt*, in which the Eighth Circuit considered that argument and expressly rejected it. In the pre-Bankruptcy Code case *Maggio*, the Supreme Court reversed the lower court’s contempt order on a debtor who was unable to turnover property of the estate that it no longer possessed. In short, pre-Code practice was that turnover ‘is appropriate only when the evidence satisfactorily establishes the existence of the property or its proceeds, and possession thereof by the defendant at the time of the proceeding.’ The Supreme Court further clarifies that courts should not look to the date of bankruptcy as the time to which the inquiry of possession is directed, but rather to the time that a turnover proceeding is instituted. In this case, Debtor does not possess the property or the proceeds of the property.”); *In re Falzerano*, 454 B.R. 81, 86 (B.A.P. 8th Cir. 2011) (“Moreover, the limitation . . . on the trustee’s right to turnover to the proceeds in Rice’s possession comports with the Court of Appeals’ more recent ruling in *In re Pyatt*, wherein it stated unequivocally that § 542(a) permits a trustee ‘to compel turnover only from entities which have control of property of the estate or its proceeds at the time of the turnover demand.”); *In re Anderson*, 410 B.R. 289 (Bankr. W.D. Mo. 2009) (“The Trustee concedes that

reasoning, however, is flawed. The enactment of the Bankruptcy Code altered the pre-Code “current possession or control” requirement because section 542(a) expressly permits a trustee to recover “the value” of the property, in addition to the property itself, from one who possessed the property at any time “during the case.”

IV. THE TRUSTEE’S ABILITY TO RECOVER ACCOUNT FUNDS PAID POST-PETITION

Notwithstanding all that has been decided, it remains unsettled whether the trustee can obtain the transferred funds through a motion for turnover against the debtor, or whether he must seek post-petition payments from the payees of the checks. Nearly all bankruptcy court decisions addressing the floating check controversy agree that if the funds are in the debtor’s bank account on the petition date, such funds are property of the estate. As the concurrence in *In re Pyatt* pointed out, “there is no doubt that the funds on deposit in the debtor’s account when the case was filed were property of the estate. This is true whether one thinks of that property as cash, a credit of some sort, or a debt owed by the bank to the debtor.”¹¹⁹ However, the second requirement of a section 542(a) claim

under the Eighth Circuit’s decision in *In re Pyatt*, a debtor is not required to turn over money represented by checks which had been written prior to the bankruptcy filing, but had not yet cleared until after the bankruptcy case was filed.”);

¹¹⁹ *In re Pyatt*, 348 B.R. at 787 (concurring opinion). Since the controversy surrounding the floating check issue does not necessarily involve whether the

(i.e., “possession, custody, or control during the [bankruptcy] case”) is not clear-cut and the courts that have considered this matter have arrived at completely opposite conclusions. Some hold that the trustee bears the burden to seek the post-

funds in question are “property of the estate,” this Article focuses on the dispute with respect to the second element of a section 542(a) turnover action:

“possession, custody, or control” during the bankruptcy case. However, it is important to point out that while the majority of courts that have considered the floating check issue have analyzed “property of the estate” and “possession, custody, or control” separately, this is not necessary and, perhaps, is a flawed method. When most bankruptcy courts analyze the issue of “property of the estate” in other contexts, they focus heavily on the concept of dominion and control. Indeed, the Tenth Circuit has held that dominion and control over property are the hallmarks for determining whether property is property of a bankruptcy estate. *See In re Marshall*, 550 F.3d 1251, 1255 (10th Cir. 2008) (“a transfer of property will be a transfer of an interest of the debtor in property if the debtor exercised dominion or control over the transferred property.”); *In re Amdura Corp.*, 75 F.3d 1447, 1451 (10th Cir. 1996); *In re Paige*, 413 B.R. 882, 909 (Bankr. D. Utah 2009) (“The Tenth Circuit has interpreted [section 541] to mean that property that is titled in the name of the debtor and that is under the debtor’s “dominion or control” is presumptively property of the estate.”).

Accordingly, one might argue that the courts are putting the cart before the horse, so to speak, since a determination of what constitutes “property of the estate” can oftentimes be made by first analyzing the issue of dominion and control.

petition payments from the payees of the checks through avoidance actions, while others put the onus on the debtor to turn over the funds, even if those funds have been transferred from the estate to payees.

As set forth below, section 542(a) not only entitles the trustee to recover from the debtor, but may be the best method of maximizing the estate and providing the greatest return to creditors.

A. It Is Not Until the Checks Have Been Presented for Payment to the Debtor's Bank that the Debtor Ceases to Have Possession, Custody, or Control of the Funds Represented by the Checks.

The phrase “possession, custody, or control” is not defined in the Bankruptcy Code. When construing a term (where not defined in a statute), it is proper for a court to look to its commonly approved usage, an inquiry that is enhanced by the examination of dictionary definitions. Black’s Law Dictionary defines “possession” as “having or holding property in one’s power; the exercise of dominion over property Something that a person owns or controls.”¹²⁰ “Custody” is defined as “[t]he care and control of a thing or person for inspection, preservation, or security.”¹²¹ And “control” is defined as “[t]he power or authority to manage, direct, or oversee.”¹²² The phrase “possession, custody, or control” is

¹²⁰ BLACK’S LAW DICTIONARY (9th ed. 2009).

¹²¹ *Id.*

¹²² *Id.*

disjunctive and only one of the numerated requirements need be met. Thus, “actual possession” is not required.¹²³

In the case of transferred funds from a bank account, given that a check is a negotiable instrument, the most relevant provisions governing the status of funds represented by an issued check, specifically as to who is in “possession, custody, or control,” are those found in the Uniform Commercial Code. Nearly all states have adopted the Uniform Commercial Code by statute.¹²⁴

¹²³ *See, e.g., In re U.S.A. Diversified Products, Inc.* 196 B.R. 801, 809 (N.D. Ind. 1996) (noting that Congress wrote the phrase “possession, custody or control” in the disjunctive rather than the conjunctive and stating, “[n]othing in the phrase indicates that an entity must have any kind of ‘dominion’ over the property in question So, while the law firm may not have had “control” over the money since it could only transfer it pursuant to the directives of its client, that did not prevent the firm from having ‘possession’ or ‘custody,’ which is enough to make it subject to a turnover action under § 542. To interpret the phrase ‘possession, custody or control’ as restrictively as appellant urges would fly in the face of the broad intent and purpose of §§ 541 and 542.”).

¹²⁴ *See, e.g., U.S. v. Philadelphia Nat. Bank*, 304 F. Supp. 955 (E.D. Pa. 1969); *In re Long*, 519 F.3d 288, 297 (6th Cir. 2008) (recognizing that the U.C.C. “has been adopted by most states”); *In re D & K Aviation, Inc.*, 349 B.R. 169 (Bankr. S.D. Ohio 2006) (stating that the UCC is effective “in most states”); *ABB Power T & D Co., Inc. v. Gothaer Versicherungsbank VVAG*, 939 F. Supp. 1568,

Under the Uniform Commercial Code, the payee of an ordinary, uncertified check only obtains possession and control of those funds represented by the check once the funds are physically present in the payee's account.¹²⁵ But simply because a check has been issued, does not result in the payor losing possession and control of the funds.

Article 3 of the Uniform Commercial Code applies to negotiable instruments.¹²⁶ Section 3-408 provides that a "check or other draft does not of

1580 (S.D. Fla. 1996) (noting that the "Uniform Commercial Code did not exist before 1962, and most states began adoption after publication of the 1962 text.").

¹²⁵ U.C.C. § 3-408.

¹²⁶ U.C.C. § 3-102(a). "Negotiable instrument" means "an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it: (1) is payable to the bearer or to order at the time it is issued or first comes into possession of a holder; (2) is payable on demand or at a definite time; and (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor." *Id.* § 3-104(a).

itself operate as an assignment of funds in the hands of the drawee¹²⁷ available for its payment, and the drawee is not liable on the instrument until the drawee accepts it.”¹²⁸ Thus, upon receipt of a check by the payee, the payor has not effectively assigned the funds in the payor’s bank account pending payment of the check.

Moreover, regarding whether the funds remain in the payor’s account and hence in the payor’s possession or control up until presentment, section 3-501 defines presentment as “a demand made by or on behalf of a person entitled to enforce an instrument: (i) to pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank, or (ii) to accept a draft made to the drawee.”¹²⁹ Presentment has been construed as the point in time where the payee’s bank presents the check to the payor’s bank for payment.¹³⁰ Significantly, after the payor issues the check to the payee, but before presentment of the check to the payor’s bank, the funds represented by the check undoubtedly remain in the payor’s account and under the

¹²⁷ “Drawee” means a person ordered in a draft to make payment. *Id.* § 3-103(4).

¹²⁸ *Id.* § 3-408.

¹²⁹ *Id.* § 3-501(a).

¹³⁰ *Florida Nat’l Bank at Perry v. Citizens Bank of Perry*, 474 So. 2d 852, 853 (Fla. 1st DCA 1985) (using the term “presentment” in construing the exchange between banks where the collecting bank would bring checks to the payor bank and request payment for the checks).

payor's control. Indeed, it is not until presentment that issuance of a check constitutes full and absolute payment.¹³¹

Other indications of “possession, custody or control” are found in Article 4 of the Uniform Commercial Code, which applies to bank deposits and collections.¹³² Specifically, section 4-403 deals with the “Customer’s Right to Stop Payment” and provides in part:

A customer or any person authorized to draw on the account if there is more than one person may stop payment of any item drawn on the customer’s account or close the account by an order to the bank describing the item or account with reasonable certainty received at a time and in a manner that affords the bank a reasonable opportunity to act on it before any action by the bank with respect to the item described in section 4-303. If the signature of more than one person is required to draw on an account, any of these persons may stop payment or close the account.¹³³

¹³¹ See Henry J. Bailey & Richard B. Hagedorn, *Brady on Bank Checks* § 4.6 (7th ed. 1992) (“Since delivery of an ordinary, uncertified check is only conditional payment, dependent on the check being honored upon presentment, the check vests *no title or interest* in the payee as to funds on deposit in the drawer’s bank account and the check is deemed revocable by the drawer until it is paid.”).

¹³² See U.C.C. § 4-101 (“This Article may be cited as Uniform Commercial Code—Bank Deposits and Collections.”).

¹³³ *Id.* 4-403.

Thus, a payor of a check may issue a stop payment order at any time after the check has been written in an attempt to prevent the check from being paid and the funds from being transferred to the payee. This “right to stop payment” is clearly indicative of the “possession, custody, or control” a debtor has over funds in a bank account. A court should be hard pressed to deny that a debtor is not in control over funds in her account if she can actually take steps to stop payment of the check.¹³⁴

Furthermore, the United States Supreme Court has confirmed that under the Bankruptcy Code, a “transfer” of a check occurs when the drawee bank honors the check, not when the payee receives it.¹³⁵ Accordingly, any time before a bank

¹³⁴ *In re Schoonover*, No. 05-43662-7, 2006 WL 3093649, at *1 (Bankr. D. Kan. Oct. 30) (“Debtors also do not, and really cannot, dispute, that they had management of, or control over, the funds deposited in the accounts.”)

¹³⁵ *Barnhill v. Johnson*, 503 U.S. 393, 400–01 (1992). The issue of when a “transfer” is deemed to have occurred is regularly discussed in the context of “preferences” under title 11, section 547 of the United States Code. Pursuant to section 547, a trustee may avoid any transfer of an interest of the debtor in property if the transfer (1) was made to a creditor, (2) was for payment of debt, (3) was made while the debtor was insolvent, (4) was within 90 days before the filing of the bankruptcy (one year if the creditor was an “insider” of the debtor), and (5) allowed to the creditor to recover more than he would recover in a Chapter 7 liquidation. The date the “transfer” occurs can provide a significant defense to a creditor when litigating whether the payment was made within 90

honors a check, the funds represented by that check are within the “possession, custody, or control” of the payor (i.e., the debtor in this case).¹³⁶

There are several other factors that demonstrate a debtor’s control over the funds in her account. These include, among other things, the ability to (1) manage days. Under *Barnhill*, the “date of honor” rule, not of delivery, applies to preferential transfers under section 547(b).

In *In re Pyatt*, 486 F.3d 423, 427 (8th Cir. 2007), the Eighth Circuit, citing *Barnhill*, found that the debtor “had control over the funds before the checks were honored.” Remarkably, when deciding that the debtor was not responsible for replenishing the estate, the *Pyatt* court did not dispute that the debtor had “possession, custody, or control” over the funds at some point during the case. The *Pyatt* court recognized that before a bank honors the checks, the funds represented by those checks are within the possession, custody, or control of the debtor.

Relatedly, some debtors have argued that when a creditor presents a check for payment post-petition, that such act is a violation of the automatic stay. However, to the contrary, section 362(b)(11) excepts from the stay “the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument.” 11 U.S.C. § 362(b)(11).

¹³⁶ See *In re Parker*, No. 05-17912, 2008 WL 906570, at *4 (Bankr. N.D. N.Y. April 3, 2008) (holding that “[t]he recipient of a check has not right to funds in an account until the check is presented for payment.”)

the account, (2) determine when funds will be disbursed and to whom, (3) close the bank account, (4) contact the bank and provide the bank with notice of the bankruptcy, (5) withdraw the funds from the bank, (6) use a debit card to purchase goods, and (7) transfer funds from one account to another.¹³⁷ Thus, there can really be no question that if, on the day a debtor files for bankruptcy, the issued checks have not been honored, the debtor has complete “possession, custody, or control” of the funds represented by those checks. But this still leaves the question of whether that “possession, custody, or control,” which may last for only a day or a few hours after the bankruptcy case is filed, constitutes possession, custody, or control “during the case,” which is required by section 542(a).

B. A Debtor’s Control of Her Bank Account Funds on the Date of Filing Requires the Debtor to Deliver to the Trustee Such Funds or the Value of Such Funds.

¹³⁷ It is important to note that the floating check controversy and the section 542(a) analysis are not questions of what a debtor *should* do, but what a debtor *can* do. The issue is not the debtor’s duty; the issue is the debtor’s control of the funds in the bank account. The fact that a debtor *can* perform all of these tasks, which no courts dispute, demonstrates that a debtor has complete control over funds in her bank account until the moment of honor. It is the debtor’s control that is the key for purposes of section 542(a), not what otherwise might be their duty. It is important to note, however, that pursuant to 11 U.S.C. § 521(a)(4), debtors have an explicit duty to “surrender to the trustee all property of the estate.”

As set forth above, several courts make the argument that funds in the debtor's account as of the bankruptcy filing, which were dissipated post-petition, are not subject to turnover by the debtor pursuant to section 542(a).¹³⁸ These courts base their decisions upon flawed interpretations of the Bankruptcy Code and outdated common practice under the former Bankruptcy Act. Regarding the former, these courts conclude that section 542 has to be interpreted as permitting recovery against only a person who is *currently* in possession or control of the subject property at the time of the turnover action—otherwise, there could be an unintended double recovery. In *Pyatt*, for example, the Eighth Circuit made the following conclusion:

¹³⁸ See, e.g., *In re Henson*, 449 B.R. 109, 112–13 (D. Nev. 2011) (holding that because debtor no longer had possession of the funds, trustee could not compel turnover); *In re Falzerano*, 454 B.R. 81, 86 (B.A.P. 8th Cir. 2011) (holding that section 542(a) permits a trustee to compel turnover only from entities that have control of property of the estate or its proceeds at the time of turnover demand); *In re Anderson*, 410 B.R. 289 (Bankr. W.D. Mo. 2009) (holding that the trustee could only proceed against the payees of the checks and not the debtor); *In re Taylor*, 332 B.R. 609 (Bankr. W.D. Mo. 2005) (“The Trustee concedes that under the Eighth Circuit’s decision in *In re Pyatt*, a debtor is not required to turn over money represented by checks which had been written prior to the bankruptcy filing, but had not yet cleared until after the bankruptcy case was filed.”);

Here, both the debtor and the debtor's payees had "possession, custody, or control" of the funds at some point after the bankruptcy petition was filed. Under the trustee's reading of the provision, the trustee could proceed both against the debtor and against the payees and obtain double satisfaction. The code's drafters apparently did not think it necessary to prevent the trustee from obtaining double satisfaction under § 542(a). *Cf.* 11 U.S.C. § 550(d) (prohibiting double satisfaction in avoidances under §§ 544, 545, 547–549, 553(b), and 724(a); no mention of § 542(a)). The absence of such a prohibition suggests that the drafters did not intend to authorize a trustee to proceed under § 542(a) against everyone who may have had control over property of the estate at some point after the petition was filed.¹³⁹

This argument raised in *Pyatt* and the meaning of section 550 of the Bankruptcy Code need further explanation. *Pyatt* (and other courts) cites to section 550 of the Bankruptcy Code for support that an unintended double recovery might occur if a trustee is allowed to pursue a debtor for the value of the funds transferred post-petition. This reasoning is faulty.

Section 550 of the Bankruptcy Code permits a trustee, after *avoidance* of a transfer under the trustee's *avoiding* powers, to recover the property transferred or the value of the property transferred.¹⁴⁰ Section 550 only applies to section 544 (transfers invalid against subsequent judicial lien creditors and *bona fide* purchasers or against actual creditors);¹⁴¹ section 545 (invalid statutory liens);¹⁴²

¹³⁹ *In re Pyatt*, 486 F.3d 423, 427–28 (8th Cir. 2007).

¹⁴⁰ 11 U.S.C. § 550.

¹⁴¹ *Id.* § 544.

¹⁴² *Id.* § 545.

section 547 (preferences);¹⁴³ section 548 (fraudulent transfers and obligations);¹⁴⁴ section 549 (post-petition transfers);¹⁴⁵ section 553(b) (setoffs within 90-day pre-petition period);¹⁴⁶ and section 724(a) (lien secured by penalties).¹⁴⁷ Under section 550, the Trustee may recover the property itself or, on court order, the value of the property. Furthermore, the trustee may recover the property from the initial transferee or a subsequent transferee. Section 550(d), however, prevents the trustee from obtaining a windfall for the estate by recovering from multiple transferees so that the recovery is in excess of the value of the property transferred.¹⁴⁸ Section 550(d) provides that “[t]he trustee is entitled to only a single satisfaction under subsection (a).”¹⁴⁹ “Subsection (d) recognizes the possibility that more than one entity may be liable, but that the trustee’s remedy is limited to the recovery of property or its value, and not damages.”¹⁵⁰ For example, if “the trustee could recover under subsection (a)(1) from either the initial transferee or from the entity for whose benefit the transfer was made, the trustee

¹⁴³ *Id.* § 547.

¹⁴⁴ *Id.* § 548.

¹⁴⁵ *Id.* § 549.

¹⁴⁶ *Id.* § 553.

¹⁴⁷ *Id.* § 724.

¹⁴⁸ *Id.* § 550(d).

¹⁴⁹ *Id.*

¹⁵⁰ COLLIER, *supra* note 13, at ¶ 550.05 at 550-27.

may recover from both, but only insofar as the recovery does not exceed the value of property or the property itself.”¹⁵¹

Section 550, of course, does not mention section 542(a) because section 542(a) is not an avoidance provision. So *Pyatt* and others¹⁵² make the argument that because section 542(a) is not mentioned, there is nothing that would prohibit a trustee from obtaining a double recovery—once from the debtor and once from

¹⁵¹ *Id.*

¹⁵² For example, in the recent case of *In re Henson*, the court followed a nearly identical analysis as *Pyatt*, stating: “Finally, we note that under Trustee’s interpretation of sec. 542(a), Trustee might have obtained double satisfaction by proceeding against the debtor through a motion for turnover, and against the creditors through a motions to avoid post-petition transfers. If possession is not required, nothing in sec. 542(a) or the provision governing double satisfaction would prevent Trustee from doing so. Double satisfaction under sections 533, 545, 547, 548, 549, 553(b), or 724(a) is expressly prohibited under 11 U.S.C. § 550(d). That provision does not include any reference to sec. 542(a), and the absence of such a prohibition lends credence to our interpretation that sec. 542(a) requires present possession of the property or its proceeds. Our interpretation would neatly limit the appropriate defendants of a turnover proceeding and the possibility of double satisfaction without resort to an express provision such as sec. 550(d), as well as being in accordance with pre-Code practice.” *In re Henson*, 449 B.R. 109, 113 (D. Nev. 2011).

the payees to whom the checks were transferred. This argument borders on the frivolous.¹⁵³

It is ultimately the trustee's duty to collect property of the estate "as expeditiously as is compatible with the best interests of the parties in interest."¹⁵⁴ Spending additional time and wasting the estate's resources to collect funds, which the trustee has already obtained, would violate his duties under the Bankruptcy Code. Furthermore, if a trustee were to actually seek a double recovery, the party from whom the second recovery was sought could clearly raise equitable defenses against such actions. Most, if not all, states forbid double recovery. Indeed,

[i]t is generally recognized that there can be only one recovery for one wrong or injury. Double recovery of damages is not permitted, and the law does not permit a double satisfaction for a single injury. A plaintiff may not recover damages twice for the same injury simply because he or she has two legal theories.¹⁵⁵

Furthermore, if a trustee recovered from the debtor under section 542(a) and then attempted a double recovery against the payee under section 549, what

¹⁵³ As noted by one court, "it would be extremely unusual for § 542(a) to be referenced in § 550(d), as a matter of statutory construction." And "little, if anything, should be read into the failure to include § 542(a) in the provisions of § 550." *In re Ruiz*, 455 B.R. 745, 751 (B.A.P. 10th Cir. 2011).

¹⁵⁴ 11 U.S.C. § 704(1).

¹⁵⁵ 25 C.J.S. *Damages* § 5 (2011).

would prevent the payee from asserting a section 550(d) defense and what court would allow a trustee to obtain such a windfall?

Finally, *Pyatt's* concern about double recovery is not remedied by the holding that an entity is required to have *current* possession or control over estate property to be subject to a turnover action. As correctly stated by one court, “in a case where funds remain in a checking account on the date a trustee seeks turnover, both the bank (which would currently be in *possession* of the funds) and the debtor (who would currently be in *control* of the funds) could be the subject of the trustee’s turnover demand.”¹⁵⁶ Accordingly, the double recover that the *Pyatt* court and others fear could still occur.

Another problem with *Pyatt's* conclusion—and possibly even a greater problem—is that it opens the door for serious abuse of the bankruptcy process. *Pyatt* focuses on the remote possibility of unintended double recovery, but completely ignores the consequences of its holding. If, as *Pyatt* concludes, section 542(a) actually permits a debtor to use or transfer property of the estate without consequence, does this not open the door for debtors to game the bankruptcy system? Indeed, under *Pyatt's* reasoning, debtors may now be incentivized to dissipate assets of the estate under the assumption that as long as they are not in “possession” of the property, no penalties will follow.¹⁵⁷ In *In re Anderson*,¹⁵⁸ for

¹⁵⁶ *Ruiz*, 455 B.R. at 752.

¹⁵⁷ This could, of course, jeopardize a debtor’s discharge under 11 U.S.C. § 727. But actual intent to hinder, delay or default must be established. And as *Pyatt* illustrates, it is certainly possible for a debtor to benefit from post-petition

example, a case which follows the *Pyatt* decision, the debtors argued that *Pyatt* stands for the proposition that, even though funds in a debtor’s checking account as of the petition date are clearly property of the estate, a debtor is free to write checks on such account *post-petition*, without consequence, up until the time that the trustee makes demand for turnover of such funds.¹⁵⁹ Stated differently, if a debtor is able to dissipate funds from her checking account before the trustee has a chance to review her bank statements and make a turnover demand for such funds, the debtor is off the hook—the trustee must look elsewhere to recover those funds.¹⁶⁰ While the court in *Anderson* essentially rejected the debtors’ argument, it is further proof that *Pyatt*’s interpretation of section 542(a) is flawed and that debtors will use *Pyatt* as a good-faith justification to game the system. Undoubtedly, debtors and bankruptcy practitioners alike will read *Pyatt* to mean that a debtor is free to spend or transfer estate funds post-petition until such time as the trustee makes demand for such funds.¹⁶¹

transfers made without also possessing the requisite fraudulent intent.

Furthermore, denying the debtor a discharge will not restore to the estate property that otherwise could have been distributed to creditors. *In re Fleming*, 424 B.R. 795, 802–03 (W.D. Mich. 2010).

¹⁵⁸ 410 B.R. 289 (W.D. Mo. 2009).

¹⁵⁹ *Id.* at 295.

¹⁶⁰ *Id.*

¹⁶¹ Creditors would also have an incentive to game the system. *See, e.g., Yoon v. Minter-Higgins*, 399 B.R. 34, 43–44 (N.D. Ind. 2008) (stating that “it

Thus, *Pyatt's* argument regarding the potential of double recovery by the trustee to support the requirement of current possession of property in a turnover action under section 542(a) is without merit and should not be followed.¹⁶²

would be simple for debtors and aggressive creditors to game the system by writing checks immediately pre-petition to pay selected creditors while remaining secure in the knowledge that the trustees would be unlikely to pursue very small § 549 [unauthorized post-petition transfers] actions. This in turn would result in an unfair distribution to those creditors the debtors chose not to pay pre-filing and defeat the Code's policy of promoting a fair distribution of the debtor's assets."); *In re Shearin*, 224 F.3d 353, 357 (4th Cir. 2000) (stating that to read section 542(a) as requiring current possession "would enable possessors of property of the estate to escape trustees' demands simply by transferring the property to someone else." (quotations omitted)); *In re Fleming*, 424 B.R. 795, 805 (W.D. Mich. 2010) (rejecting the debtors' "contention that they can in effect exonerate themselves from their responsibility to account to Trustee for property that clearly belonged to the estate through the simple expedient of having spent it.").

¹⁶² It is worth noting that the debtor may have to pay twice under any scenario. If the trustee seizes the money from the debtor's account, the result may be a bounced check. On the other hand, if the trustee pursues the payees directly, the debtor may need to make amends with the creditors depending on the nature of the debt. For example, if a debtor made a payment to his mortgagee pre-petition and the trustee seized the funds representing the check to the mortgagee post-petition, the debtor would still have an obligation to pay the mortgagee.

Pyatt and similar courts also base their decisions under the former Bankruptcy Act—despite the enactment of the Bankruptcy Code in 1978—as well as the pre-Code United States Supreme Court case of *Maggio v. Zeitz*.¹⁶³ *Pyatt* made these observations regarding the floating check controversy and pre-Code practice:

Precode practice suggests that § 542(a) permits a trustee to compel turnover only from entities which have control of property of the estate or its proceeds at the time of the turnover demand. Precode practice is relevant in construing the bankruptcy code. It is especially instructive when interpretation of a “judicially created concept” is at issue, and turnover proceedings were an uncodified creation of the courts before enactment of the current code.

The leading case on pre 1978 turnover proceedings is *Maggio v. Zeitz*. There, the president of a bankrupt enterprise was ordered to turn over property which he did not have. He was jailed for contempt when he did not comply with the order. The Supreme Court held that the president was not a proper defendant in a turnover action, for turnover proceedings are permissible “only when the evidence satisfactorily establishes the existence of the property or its proceeds, *and possession thereof by the defendant at the time of the proceeding.*” The use of a turnover remedy was inappropriate “if, at the time it is instituted, the property and its proceeds have already been dissipated.” Precode practice thus required control of the property at the time the motion to compel turnover was brought.¹⁶⁴

Pyatt, however, does not adequately appreciate the differences between the old Bankruptcy Act and the current Bankruptcy Code, which clearly altered the

Since the mortgagee is secured by the debtor’s residence, if the debtor wants to remain in the property, he or she will need to stay current on their mortgage.

¹⁶³ *Maggio v. Zeitz* (*In re Luma Camera Serv., Inc.*), 333 U.S. 56, 61 (1948).

¹⁶⁴ *Pyatt*, 424 B.R. at 428–29 (internal citations omitted).

pre-Code possession requirements. Furthermore, pre-Code practice is applicable only if Congress, in enacting the Bankruptcy Code, has been ambiguous or the pertinent code section (i.e., section 542(a)) requires additional interpretation. But “where the meaning of the [Bankruptcy] Code’s text is itself clear . . . its operation is unimpeded by contrary prior practice.”¹⁶⁵

Section 542(a) provides that “an entity . . . in possession, custody, or control, *during the case*, of property . . . shall deliver it to the trustee and account for such property or the *value* of such property.”¹⁶⁶ The plain language of this statute provides that current possession is *not* a requirement under section 542(a).¹⁶⁷ “During the case” refers to the entire bankruptcy case, not just the moment a turnover proceeding is commenced by the trustee.¹⁶⁸ And what is further absent in

¹⁶⁵ *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 2 (2000).

¹⁶⁶ 11 U.S.C. § 542(a) (emphasis added).

¹⁶⁷ *In re Muniz*, 320 B.R. 697, 700 at n.2 (D. Colo. 2005) (holding the fact that a trustee cannot demonstrate debtor’s possession of estate property at the time of turnover action merely means that his remedy becomes a money judgment for the value of the estate property, rather than an order for turnover).

¹⁶⁸ *In re Shearin*, 224 F.3d 353, 356 (4th Cir. 2000) (“We construe the language “during the case” to refer to the entire bankruptcy case, not just the adversary proceeding.”); *accord In re USA Diversified Prods., Inc.*, 100 F.3d 53, 55 (7th Cir. 1996) (applying section 542(a) to “[o]ne who *during a bankruptcy proceeding* is in ‘possession, custody, or control’ of property” belonging to the

Pyatt's and other courts' decisions is appropriate deference to the ability of the trustee to now compel, pursuant to section 542, the delivery of "*the value of such property*" instead of just the property itself.¹⁶⁹ *Pyatt* acknowledges that section 542 had no counterpart under the former Bankruptcy Act, but rather turnover was a product of "judicial innovation" derived from the general concept that the courts were able to "cause the estates of bankruptcy to be collected."¹⁷⁰ But section 542(a) expanded the power to collect assets of the bankruptcy estate. Indeed, section 542(a) now provides a much broader remedy than solely turnover of property held at the time of the turnover proceeding, which likely occurs well

debtor's estate) (emphasis added); *In re Robertson*, 105 B.R. 440, 457 (Bankr. N.D. Ill. 1989) (stating that the statute "plainly applies to estate property that was possessed by anyone 'during the case' whether or not they still have it"); *In re Majors*, 330 B.R. 2005 WL 2077497, at *3 (B.A.P. 10th Cir. 2005) ("[t]he obligation to turnover extends not just to property presently in someone's possession, custody or control during the case.");

¹⁶⁹ Were that not true, the holding that debtors must repay to the estate the pre-petition portion of any tax refunds received, even when the debtor has spent the actual refunds monies, would be in doubt. *See In re Barowsk*, 949 F.2d 1516 (10th Cir. 1991) (holding that tax refunds attributable to pre-petition portion of taxable year was property of the estate).

¹⁷⁰ *Maggio v. Zeitz*, 333 U.S. 56 (1948).

after the filing of a bankruptcy petition. It contemplates the likelihood that a debtor or other entity has had and subsequently lost control of estate property.¹⁷¹

Furthermore, if the statute is read to require current possession of the property, as *Pyatt* and other courts do, then what does the language allowing the trustee to alternatively recover “the value of the property” even mean? Such an interpretation runs afoul the “long-standing canon of statutory construction that terms in a statute should not be construed so as to render any provision of that statute meaningless or superfluous.”¹⁷² Under *Pyatt*’s and similar courts’ reading of the statute, “the value of the property” has no meaning.¹⁷³ As appropriately stated by one court,

¹⁷¹ See *In re USA Diversified Prods.*, 100 F.3d 53, 56 (7th Cir. 1996) (“But by the time the trustee got around to demanding the money from the law firm, the law firm no longer had it, so how could it deliver it to the trustee? The statute, however, requires the delivery of the property *or the value of* the property. Otherwise, upon receiving a demand from the trustee, the possessory of property of the debtor could thwart demand by transferring the property to someone else. *This is not what the statute says, and can’t be what it means.*” (emphasis added)).

¹⁷² *Beck v. Prupis*, 529 U.S. 494, 506 (2000).

¹⁷³ “[I]f a lack of present possession, combined with an explanation, constitutes sufficient compliance, little, if any, purpose would be served by the statutory alternative of requiring deliver of ‘*the value of such property.*’” *In re Majors*, No. KS-04-093, KS-04-097, 2005 WL 2077497, at *3 (B.A.P. 10th Cir. August 29, 2005) (emphasis added).

[I]t is difficult for this court to read the trustee's ability under [s]ection 542 to now recover the "value of such property" as an alternative to recover the property itself as simply a reiteration of what *Maggio* recognized was a product of judicial necessity under the former Act. Rather, the common meaning of the phrase "value of such property," when juxtaposed with the notion of the property itself being turned over, suggests to this court as well as others that Congress intended to expand upon *Maggio*, rather than to codify it.¹⁷⁴

¹⁷⁴ *In re Fleming*, 424 B.R. 795, 804 (W.D. Mich. 2010); *see also In re Diversified Prods., Inc.*, 193 B.R. 868, 879 (Bankr. N.D. Ind. 1995), *aff'd sub nom.* 100 F.3d 53 (7th Cir. 1996) (stating that "[p]roceedings under § 542 effectively combine both the summary and the plenary remedies a trustee was required to pursue under the old Act, thus, allowing the pursuit in a single proceeding of relief that previously may have required two separate proceedings. Consequently, if the turnover defendant is still in possession of property of the estate, the trustee may recover that property. If the defendant no longer has possession of property of the bankruptcy estate, the court may inquire into the propriety of its disposition and, if appropriate, enter a money judgment in favor of the trustee for the value of such property. In effect, turnover proceedings have become what the Supreme Court noted they were not under the old Bankruptcy Act. They are not only the means by which the trustee can recover specific property of the estate and its identifiable proceeds, but also the means by which it can recover 'damages for tortious conduct such as embezzlement, misappropriation or *improvident dissipation of assets.*'") (quoting *Maggio*, 33 U.S. at 63).

The text of section 542(a) is plain. And “where, as here, the statute’s language is plain, the sole function of the courts is to enforce it according to its terms.”¹⁷⁵ Funds on deposit in a debtor’s bank account are undeniably “property of the bankruptcy estate.” The fact that a debtor writes checks against the funds pre-petition, but the checks do not clear the debtor’s account until post-petition, does not defeat the trustee’s right to recover the full amount transferred under section 542(a). If the checks do not clear the debtor’s account until *after* she files for bankruptcy, the debtor undeniably maintained control of the funds “during the case.” Furthermore, the statute expressly allows the trustee to recover the “value” of such funds representing the checks. Thus, all of the elements required under section 542(a) to establish a claim against a debtor for turnover of funds that remained in the debtor’s account on the day she filed her bankruptcy petition are satisfied. Although one may be sympathetic to a debtor in this situation, the law simply provides the debtor no valid defense to the trustee’s turnover action under section 542(a).

C. The Policy Concerns and the Best Interest of Creditors

Nearly every court to analyze the floating check controversy discusses the policy concerns and the difficult position that the parties, particularly the debtors,

¹⁷⁵ United States v. Ron Pair Enters., 489 U.S. 235, 241 (1989) (internal quotations omitted).

face.¹⁷⁶ The reasoning relied on by courts to arrive at their differing outcomes pertains largely to the parties' respective duties under the Bankruptcy Code.

¹⁷⁶ See, e.g., *In re Pauls*, No. 10-12887, 2011 WL 6096292, at *2 (Bankr. D. Kan. Dec. 5, 2011) (stating that “[t]he facts of this case are lamentable: an elderly grandmother’s attempt to assist her granddaughter and husband by co-signing and paying their debts results in the debtors being liable for funds they have repaid to her and that she, in turn, has paid to their creditor. But unfortunate facts do not soften the outcome that the law coldly compels. Randy and Ruth Ann Pauls had control of the \$9,713.49 in their checking account on the date of their bankruptcy petition and must be ordered to account to the trustee for it as § 542(a) requires.”); *In re Sawyer*, 324 B.R. 115, 123 (D. Ariz. 2005) (discussing the “enormous amount of sympathy for the pro se Debtors in this case who apparently acted in good faith”); *In re Dybalski*, 316 B.R. 312, 316 (S.D. Ind. 2004) (stating that “[t]he result in this case, at least on its face, seems rather unfortunate. And that “the Code is primarily intended to give debtors a “fresh start” and to equalize distribution among like creditors. The Court does not believe that either of these goals is well severed here. The Debtors, who may not be in a position to turn over the Funds, must essentially pay the same “bill” twice, with perhaps only a marginal benefit to the estate, while the creditors who received the Funds are able to retain them.” *In re Brubaker*, 426 B.R. 902, 907 (M.D. Fla. 2010) (“Although this Court has an enormous amount of sympathy for the pro se Debtors there is nothing in the record to reflect that the Debtors were acting in bad faith or with

Courts also analyze which of the parties (i.e., the trustee or the debtor) is in the best position to prevent transfers by post-petition checks and remedy the damages to the estate caused by the transfers. This focus, however, misses the mark. Courts should not be focusing on which party is in the best position, but rather what the statute requires and which of the remedies available to the trustee provides the greatest return to creditors and is in the best interest of the estate.

In *Pyatt*, for example, the United States BAP of the Eighth Circuit, in holding that the responsibility for recovery of several unauthorized post-petition transfers was properly placed on the trustee, and ignoring what was in the best interest of the estate, held that the trustee was “*in a better position* to prevent transfers by post-petition check because the trustee can do so without the risk of criminal liability.”¹⁷⁷ The court further held that “[a] trustee also is *in a better position* to remedy the damage to the estate caused by post-petition transfers because the

fraudulent intent. The Debtors simply seemed to be depositing funds, allowing debits from their account by merchants, and writing checks in the ordinary course.

¹⁷⁷ *In re Pyatt*, 348 B.R. 783, 786 (B.A.P. 8th Cir. 2006) (emphasis added). The court further found that: “A debtor, on the other hand, runs the risk of being prosecuted for writing a bad check if he attempts to stop payment on an outstanding check on the eve of bankruptcy. Even though the debtor would likely prevail if he faced criminal charges for such conduct, presuming he acted without fraudulent intent, it is still inappropriate and unnecessary to place the debtor between the “rock” of possible criminal prosecution and the “hard place” of defending a turnover action by the trustee.”

trustee is the only party authorized by the Bankruptcy Code to avoid post-petition transfers, pursuant to 11 U.S.C. § 549.”¹⁷⁸ In addition, the court found that “because a trustee is the only party the Code authorizes to recover post-petition transfers, placing responsibility on the trustee for doing so under these circumstances is also the only option that advances the goal of equal distribution among creditors.”¹⁷⁹

¹⁷⁸ *Id.* (emphasis added); *see also In re Henson*, 449 B.R. 109, 113 (D. Nev. 2011) (“Nor is Trustee left without an adequate remedy under the interpretation that a motion to compel turnover may only succeed when the entity has current possession of the property. Unlike the turnover provision, which governs the duty of an entity in possession of property of the estate during the case to turn over the property or the value of such property, sec. 549 expressly provides that ‘the trustee may avoid a transfer of property of the estate’ that occurs post-petition.”). The *Pyatt* court also observed that “[t]he bankruptcy court alluded to the possibility that the Debtor might recover from the payees of the checks in the amount the court ordered the Debtor to turn over to the Trustee,” but it did not specify any Bankruptcy Code provision that authorizes a debtor to recover funds from post-petition transferees.

¹⁷⁹ *Id.* The court also explained that: “[i]f a trustee recovers from creditors who receive the post-petition transfers of the kind at issue here, those creditors’ claims can be reinstated to the extent of the recovery, and the trustee could then equally distribute that recovery among all of the unsecured creditors. In contrast, if a debtor is held accountable for checks cashed postpetition (and

Finally, the court stated the following:

[W]hether characterized as concern for fundamental fairness or practicality, it simply *makes more sense* to directly collect the postpetition transfers from the creditors who received the transfers rather than from the debtors who, presumably, innocently made the payments prepetition. In a perfect world, there would be a place on a debtor's schedules or statement of financial affairs where outstanding checks could be readily listed, thereby alerting the trustee of the possible need to notify the bank to stop payment on those checks. In the absence of such perfection, however, debtors should be encouraged to disclose that information to their attorneys who, in turn, can communicate that to the trustee in some fashion. And the transfers that slip through the cracks could be avoided by the trustee.¹⁸⁰

But what “makes more sense” should not be the focus. There is no question that the floating check issue places a debtor in a problematic situation. The funds that were in the debtor's checking account on the date the debtor files for bankruptcy are no longer available. Accordingly, this will likely require the debtor to pay the funds twice—once to the payees to whom the checks were originally payable, and a second time to the trustee.¹⁸¹ Admittedly, this result

actually has the money to repay those funds), the trustee's subsequent distribution of those funds would not be equal among creditors because the creditors who have received the unauthorized postpetition transfers will have already been paid 100 percent of what they were owed (to the extent of the transfers), whereas other creditors would most likely receive less than 100 percent.”

¹⁸⁰ *Id.* at 787.

¹⁸¹ In most cases, the debtor is not purposefully cheating the bankruptcy estate. Rather, the debtor likely wrote valid checks in the ordinary course, with the

might go against the Bankruptcy Code's policy of providing a debtor with a "fresh start" through bankruptcy. However, allowing the trustee to recover the value of the funds from the debtor may be in the best interest of the bankruptcy estate and comports with the trustee's duties under section 704 of the Bankruptcy Code.

As set forth in Part II, a Chapter 7 trustee is "charged with marshaling the non-exempt assets of the estate for the benefit of creditors."¹⁸² When pre-petition checks dilute the bankruptcy estate post-petition, the Bankruptcy Code provides trustees with various *non-exclusive* remedies to reimburse the estate.¹⁸³ Some of the remedies include the following:

belief that the checks would clear prior to filing for bankruptcy. In *In re Ruiz*, for example, several of the checks were made as necessary business expenses, including hay and feed for livestock, which, by the time the trustee made demand for turnover, had been consumed by debtors' livestock. *Ruiz*, 440 B.R. at 199.

¹⁸² *In re Parker*, No. 05-17912, 2008 WL 906570, at *5 (Bankr. N.D. N.Y. April 3, 2008).

¹⁸³ *Id.* at *7 (stating that "[w]hile the Debtor is correct in asserting that the Trustee could have sought to recover the funds from the payees of the checks by seeking to avoid the post-petition transfers (11 U.S.C. § 549), the Debtor does not point to any authority indicating that the Trustee must first exhaust his other remedies before he can seek turn over from the Debtor.").

[Trustees] can give and rely upon the Fed. R. Bankr. P. 2015(a)(4) notification to banks if they have sufficient information to do so. They can seek to recover the funds from the payees of the checks by pursuing an avoidance action under § 549. Or, they can seek recovery of the funds from the debtor without an adversary proceeding by invoking either the debtor's duty to surrender under § 521(a) or his duty to turnover under § 542(a). It is ultimately the trustee's duty to collect the property of the estate 'as expeditiously as is compatible with the best interests of the parties in interest.'¹⁸⁴

Thus, a plain reading of the Bankruptcy Code indicates that a trustee can recover the funds from the debtor or the payees of the checks through several *non-exclusive* choices.¹⁸⁵ As one court has explained: "A Chapter 7 trustee is given a *substantial degree* of discretion in deciding how to administer the bankruptcy estate and his or her actions are governed by the business judgment standard."¹⁸⁶

¹⁸⁴ *In re Spencer*, 362 B.R. at 493 (quoting 11 U.S.C. § 704(1)) (adopting the holding of *In re Sawyer*, 324 B.R. at 115 and *In re Maurer*, 140 B.R. at 744).

¹⁸⁵ Debtors in several cases make the argument that in addition to section 549, recovery should come from the payees of the checks pursuant to section 547 (i.e., preferential transfers). Section 547 is not applicable. As set forth, *supra*, a "transfer" occurs when the check is honored, not received by the creditor. Thus, with respect to the floating check controversy, the checks, although issued pre-petition, are not honored until after the bankruptcy is filed, post-petition. Accordingly, the preferential transfer theory asserted by some debtors is not an option for the trustee to pursue to recover the funds.

¹⁸⁶ *In re Beery*, 2007 Bankr. LEXIS 1868, at *17 (Bankr. N.M. May 30, 2007) (emphasis added).

Accordingly, a trustee has significant discretion in deciding how to maximize the estate and his or her decisions should not be disturbed if they are reasonable under the circumstances. This means that the trustee is not required to prosecute the payees of the checks under section 549 (although he certainly can) if it makes more sense to pursue the debtor pursuant section 542(a).

Pyatt and other courts have opposed this position and have failed to consider the best interests of the estate and the trustee's "substantial degree of discretion." These courts also disregard the plain language of section 542(a) and instead make policy-based arguments that the trustee is in the best position to prevent this situation by immediately notifying the debtor's banks of the bankruptcy filing.¹⁸⁷ Despite misinterpreting the Bankruptcy Code and ignoring the trustee's duties, these holdings assume the trustee receives sufficient information to do so within days or even hours of the commencement of the case.¹⁸⁸ More significantly, the

¹⁸⁷ See *Pyatt*, 384 B.R. at 785.

¹⁸⁸ *In re Parker*, No. 05-17912, 2008 WL 906570, at *6 (stating that "these courts place the burden on the trustee, in reliance on the duty imposed under Federal Rule Bankruptcy Procedure 2015(a)(4), to notify a debtor's bank of the bankruptcy filing so that no further checks would be honored, or to stop payment on any outstanding checks. If a bank honor a check before receiving notice of the filing, they assert the trustee could seek to recover from the payee under § 549(a). This problem with this rationale is that often a debtor's check may clear post-petition before the trustee is notified of his appointment, assuming the trustee has been provided with all the information needed to notify the debtor's financial

Pyatt court and others assume that the debtor's statements and schedules will be filed immediately and contain accurate information relating to the bank accounts, including (1) account numbers, (2) bank names, and (3) actual amounts in the accounts. Assuming all of that, courts argue that the trustee has all of the necessary information to take quick action. In reality, however, those assumptions

institution. More often than not, the debtor merely discloses a "checking account" on schedule B, without any identifying account information. In addition, most debtors do not identify outstanding checks at the time of filing, and it is not until the first meeting of creditors that the trustee learns of these estate assets."); *In re Spencer*, 362 B.R. 489, 493 (Bankr. D. Kan. 2006) ("In the present case (as in many, the Court suspects), the debtors did not identify which bank branches held their accounts or the applicable account numbers, making it difficult for the trustee to give the Rule 2015 notification. In addition, had the trustee made the notification, both banks would likely have frozen the accounts, exposing the debtors to the criminal and civil penalties that attend returned checks and thwarting their fresh start by rendering the debtors unable to use their accounts at all. Moreover, most of the checks written and honored post-petition were for a few hundred dollars each. Had the trustee chosen the § 549 route, he would be burdened with commencing a plethora of § 549 actions to recover two or three hundred dollars. This would be a poor economy of the estate, not to mention wasteful of the Court' time and resources. One could hardly consider it "expeditious" as § 704 requires.").

are far from accurate.¹⁸⁹ As often as not, the debtor's statements and schedules will be missing or misstate a piece of crucial information. Indeed, in most cases, the debtor's Statement of Financial Affairs will erroneously indicate the balance

¹⁸⁹ See, e.g., *In re Parker*, No. 05-17912, 2008 WL 906570, at *5 (Bankr. N.D. N.Y. Apr. 3, 2008) (noting that “[t]he Debtor did not provide the Trustee with his account number or the branch where he does his banking. It was not until the Trustee reviewed the Debtor’s bank account statements that he was able to ascertain the actual account balance at filing and the Debtor’s account number. Thus, the Trustee was not in a position to put Trustco Bank on notice of the filing under Federal Rule of Bankruptcy Procedure 2015(a) prior to the checks at issue being presented for payment.”); *In re Ruiz*, 455 B.R. 745, 754 (B.A.P. 10th Cir. 2011) (“This case provides a good example why this is not practical [for the trustee to recover the funds from others]. This bankruptcy was filed on a Saturday. It would be a rare situation for a panel trustee to 1) be sitting in his or her office on a weekend, with staff, in the off-chance a bankruptcy would be filed; 2) that he would necessary be the one appointed as the panel trustee on that new case; 3) that the schedules would show the existence of enough money in a checking account worth immediately acting on; and 4) that the schedules would provide sufficient information to allow the trustee to contact any listed banking institutions. In addition, since all four checks cleared within four days of the bankruptcy filing (and one the first business day after it was filed), even if the Trustee had mailed the letter the first business day the case was received, he could not have prevented the check from being honored.”).

that they presumed would be in the account *after* the checks clear.¹⁹⁰ Moreover, under the Bankruptcy Code, debtors are not required to submit their statements and schedules until 15 days after filing the initial petition.¹⁹¹ This 15-day period alone eliminates the trustee's ability to issue notice of the bankruptcy filing to the banks in sufficient time to prevent pre-petition checks from clearing.

In all reality, the debtors are clearly in the best position to prevent pre-petition checks from diluting the bankruptcy estate:

[D]ebtors (especially those represented by knowledgeable bankruptcy counsel) are in the best position to prevent this situation. First, and undoubtedly the most simple solution, is for debtors to wait until all outstanding checks have cleared the bank before filing their petition. Second, if immediate filing is required, because of a pending foreclosure or otherwise, they can stop payment on the outstanding checks. Third, debtors have the option of simply closing the bank accounts. Fourth, debtors can contact their banks and provide a notice of the filing of the bankruptcy petition, creating a duty on the part of the institutions to not pay the checks. It is true that the latter three options could theoretically cause debtors criminal problems on the

¹⁹⁰ See, e.g., *In re Ruiz*, 455 B.R. 745, 754 (B.A.P. 10th Cir. 2011) (“if debtors are not properly counseled, they may inadvertently indicate in their schedules the balance they show in their check register, rather than the accurate amount actually still within their account. That is what appears to have happened here; Debtors listed the account with \$10.02 balance instead of the actual amount of \$3,764.99. Since panel trustees stand to only receive \$60 in a no-asset case, the system is not set up to require those same trustees to spend their personal assets to seize a \$10 bank account.”).

¹⁹¹ See 11 U.S.C. §§ 521(a) & 707(a)(3).

back end, if someone suggested these steps were taken with the purpose to defraud. As the concurring opinion notes in *In re Pyatt*, however, “there is clearly no purpose to defraud if a bankruptcy debtor stops payment on a check in fulfillment of the debtor’s duties under a federal statute.”¹⁹²

Although trustees may have other remedies available, the Bankruptcy Code clearly allows a trustee, pursuant to section 542(a), to recover property of the estate directly from the debtor. Trustees often do not have enough information in a short enough period of time to give the Rule 2015 notification. In addition, even if a trustee did have the information soon enough and issued the notification with sufficient dispatch, banks would likely freeze the account, exposing the debtor to the very criminal or civil penalties the *Pyatt* court refers to in arguing debtors have no duty to issue stop orders on pre-petition checks.¹⁹³ In other words, the “potential” criminal liability would appear to attach regardless of who prevented the checks from clearing.¹⁹⁴ However, a debtor’s compliance with his or her duty

¹⁹² *In re Schoonover*, No. 05-43662-7, 2006 WL 3093649, at * 3 (Bankr. D. Kan. Oct. 30, 2006) (quoting *In re Pyatt*, 348 B.R. at 787 n. 13 (concurring opinion)).

¹⁹³ See *In re Pyatt*, 348 B.R. at 786.

¹⁹⁴ As noted by one court, “many, if not most, jurisdictions require the state to prove actual intent to defraud when prosecuting an individual for writing a bad check.” *In re Ruiz*, 455 B.R. 745, 753 (B.A.P. 10th Cir. 2011).

under a federal statute vitiates any purpose to defraud and such an argument is nothing more than a red herring.¹⁹⁵

Moreover, it is often several relatively insignificant pre-petition checks that are honored post-petition. If the trustee were forced to pursue such transfers under section 549, as several courts suggest, he would be forced to commence several separate actions to recover each individual amount.¹⁹⁶ As a practical consideration, requiring a chapter 7 trustee to chase down multiple transferees who received post-petition transfers will often be impossible or extremely

¹⁹⁵ See, e.g., *In re Schoonover*, No. 05-43662, 2006 WL 3093649, at *3 (Bankr. D. Kan. Oct. 30, 2006) (stating that “[i]t is true that the latter three options could theoretically cause debtors criminal problems on the back end, if someone suggested these steps were taken with the purpose to defraud. As the concurring opinion notes in *In re Pyatt*, however, there is clearly no purpose to defraud if a bankruptcy debtor stops payment on a check in fulfillment of the debtor’s duties under a federal statute.” (internal quotations omitted)).

¹⁹⁶ And as one court noted, “[o]ne must also remember . . . that if the Trustee brought an action to avoid the post-petition transfer under § 549, and recovered that transfer for the estate under § 550, the holder of the note secured by the mortgage, for example, would be entitled to a claim under § 502(h) for the amount it was required to return to the Trustee. That claim would retain its secured status, leaving Debtors in the same position with regard to the amount of money they owed the note holder on the secured claim.” *In re Ruiz*, 455 B.R. 745, 753 n.23 (B.A.P. 10th Cir. 2011).

burdensome. In fact, the Bankruptcy Code discourages—possibly prohibits—the trustee from doing so. Section 704(a)(1) requires the trustee to collect property of the estate and “close such estate as expeditiously as is compatible with the best interests of parties in interest.”¹⁹⁷ This duty is also “required by implication from other provisions in the Code and in the Federal Rules of Bankruptcy Procedure, especially Rule 1001, which provides that the rules shall be construed to secure the just, speedy and inexpensive determination of every case.”¹⁹⁸

In short, it is the trustee’s duty to the bankruptcy estate’s creditors to realize from the estate all that is possible for distribution among creditors and to this end the trustee’s best option—at times—may be to pursue the debtor for the value of the funds instead of chasing down multiple creditors, most of whom have already been harmed by the debtor’s bankruptcy filing. By recovering from the debtor, the trustee can recover the value of *all* of the pre-petition checks from one source without initiating a single adversary proceeding. In several cases, such action would be in the best interest of the bankruptcy estate and would comport with the trustee’s duties under the Bankruptcy Code.

Furthermore, placing the onus on the debtor to reimburse the estate makes the most sense because the debtor is in the best position to prevent pre-petition checks from clearing post-petition. Only the debtor has the ability to conduct the appropriate pre-petition planning to prevent this scenario from arising. Indeed, an

¹⁹⁷ 11 U.S.C. § 704(a)(1).

¹⁹⁸ COLLIER, *supra* note 13, at ¶ 704.02[3] at 704-9.

informed debtor is aware that by filing bankruptcy she is establishing the bankruptcy estate. She has knowledge that any balance in her accounts on the petition date becomes property of the estate. Thus, the simplest solution is for the debtor to conduct the appropriate pre-petition planning and wait until all outstanding checks have cleared before filing her petition. In no way does this prevent the debtor from paying ordinary bills pre-petition.

Rather, it just requires that she take certain steps to ensure that payments clear the bank prior to filing. This can be as simple as using cash or cashier's checks in the period before filing. Moreover, if immediate filing is necessary, the debtor is in the best position to prevent any outstanding pre-petition checks from clearing. For instance, the debtor can (1) put stop payment orders on the checks, (2) give the bank notice of the bankruptcy filing, or even (3) withdraw the funds and close the bank account.

Ultimately, the policy-based arguments should not overshadow the plain text of section 542(a) and courts should not be spending time determining which way the various policy arguments cut. As noted by one court, “[w]e are not free to impose our wishes to fashion an exception to the sometimes harsh results of section 542(a).”¹⁹⁹ Furthermore, it is not the “[c]ourt’s duty to create policy, but

¹⁹⁹ *In re Majors*, No. 04-093 & 04-097, 2005 WL 2077497, at *4 (B.A.P. 10th Cir. April 29, 2005); *see also In re Pauls*, No. 10-13887, 2011 WL 6096292, at *2 (Bankr. D. Kan. Dec. 5, 2011) (stating that “unfortunate facts do not soften the outcome that the law coldly compels.”).

that of congress.”²⁰⁰ Thus, “while judges might crave the freedom to always decree what is equitable and socially useful in the cases before [them] the Supreme Court says that [judges] do not possess it when a statute or rule provides *clear direction*.”²⁰¹ This “plain meaning rule has even greater force when applied to the text of the Bankruptcy Code:

Initially, it is worth recalling that Congress worked on the formulation of the Code for nearly a decade. It was intended to modernize the bankruptcy laws, and as a result made significant changes in both the substantive and procedural laws of bankruptcy In such a substantial overhaul of the system, it is not appropriate or realistic to expect Congress to have explained with particularity each step it took. Rather, as long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the *plain language* of the statute. The task of resolving the dispute over the meaning [of a statute] begins where all such inquiries must begin: with the language of the statute itself.²⁰²

The provisions of section 542(a) are clear and allowing a trustee to recover the value of the funds from the debtor further comport with his duties under the Bankruptcy Code. And although a literal interpretation of section 542(a) may

²⁰⁰ *In re Miller*, Nos. KS-06-132, 05-25745-7, 2007 WL 2332391, at *3 (B.A.P. 10th Cir. August 16, 2007) (quoting *In re Horwitz*, 197 B.R. 237, 241 (Bankr. W.D. Okla. 1994).

²⁰¹ *Id.* (emphasis added).

²⁰² *In re Armstrong World Industries, Inc.*, 320 B.R. 523, 535 (D. Del. 2005) (quoting *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240–41 (1989) (emphasis added).

produce results that Congress may not have foreseen, legislation is the function of Congress, and Congress, not bankruptcy judges, must rewrite the Bankruptcy Code. The Supreme Court's mandate for statutory construction clearly mandates bankruptcy courts to enforce the plain meaning of a facially clear statute, in spite of policy implications or pre-Code practices to the contrary. Thus, under the analysis set forth above, even if the trustee is in a better position (which he is not) and has the option of recovering from others (which he does), in no way does that affect his right to recover from the debtor pursuant to section 542(a).

The question is not who is in a better position or whether there will be unfortunate results. The question is what the Bankruptcy Code requires and what is in the best interests of the estate. Bankruptcy courts cannot disregard the clear provisions of federal and state law, which provide, at a minimum, that (1) a debtor's interest in her bank account becomes property of the estate when she files her petition, and (2) that although a debtor may not have possession of the funds represented by the checks written to creditors, she undeniably has control if the bank has not authorized, as a payor bank, final payment on such checks. Once the payor bank authorizes payment and the debtor no longer has possession or control of the funds, section 542(a) clearly entitles the trustee to a money judgment for the "value" of the funds. This result not only follows the plain meaning of section 542(a), but it is the only result that comports with the trustee's duty to realize from the estate all that is possible for distribution among creditors and "close such estate as expeditiously as is compatible with the best interests of parties in interest."

CONCLUSION

If a debtor writes checks against funds pre-petition, but the checks do not clear the debtor's account until after she files for bankruptcy, the trustee is entitled to a money judgment against the debtor for the value of the funds. Not only does this view comport with the clear text of section 542(a), but it is also may be the most practical and efficient way to maximize the value of the bankruptcy estate. The text of section 542(a) is clear. An entity in possession, custody, or control of property of the estate during the bankruptcy case “*shall* deliver to the trustee, and account for, such property or the value of such property.”²⁰³ Property of the estate is defined to include “all legal or equitable interests of the debtor.”²⁰⁴ Funds on deposit in a debtor's bank account are undeniably “property of the bankruptcy estate.”

This is true even if the debtor writes checks against the funds pre-petition, but the checks do not clear the debtor's account until after she files for bankruptcy. Up until the time the debtor's checks are presented for payment, the debtor retains control over the balance in her account. She can close the account, withdraw the funds, or stop payment on the checks, regardless of any outstanding checks. This undeniably amounts to “possession, custody, or control” within the meaning of section 542(a). Furthermore, the enactment of the Bankruptcy Code altered the

²⁰³ 11 U.S.C. § 542(a).

²⁰⁴ *Id.* § 541(a)(1).

pre-Code present possession or control requirement because section 542(a) expressly permits a trustee to recover “the value” of the property, in addition to the property itself, from one who possessed the property at any time “during the [bankruptcy] case.” Thus, present possession is no longer a prerequisite to turnover liability. Under such circumstances, a trustee can proceed directly against the debtor under section 542(a) and courts are constrained by the Bankruptcy Code to hold the debtor liable to the estate for the value of the checks written pre-petition, but cashed post-petition.

While it is undoubtedly challenging for the debtor to pay twice and experience the “fresh start” intended by bankruptcy, the burden on the debtor is entirely irrelevant. It is well within the law and the trustee’s sound discretion to decide to recover the payments from the debtor instead of the payees under section 542(a). This result not only follows the plain meaning of section 542(a), but—at times—is the only result that comports with the trustee’s duty to realize from the estate all that is possible for distribution among creditors and “close such estate as expeditiously as is compatible with the best interests of parties in interest.” While this may be an unfortunate result, it is entirely avoidable by pre-petition planning on the debtor’s part. Debtors seeking to avoid the unpleasant result of multiple payments should be certain that any checks they write pre-petition have cleared before they file for bankruptcy. If immediate filing is necessary, the debtor can place stop payment orders on the checks, give the bank notice of the bankruptcy filing, or even withdraw the funds and close the bank account.

